Tax Planning in Practice: A Field Study of US Multinational Corporations

by

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Abbreviations

ABA	American Bar Association
AEA	American Electronics Association
AICPA	American Institute of Certified Public Accountants
APB	Accounting Principles Board
APA	Advance Pricing Agreement
BU	Business Unit
CAQDAS	Coding and Computer Aided Data Analysis Software
CEO	Chief Executive Officer
CFO	Chief Financial Officer
CPA	Certified Public Accountant
EATI	European American Tax Institute
EMEA	Europe, Middle East and Africa
EPS	Earnings Per Share
ETR	Effective Tax Rate
EU	European Union
FASB	Financial Accounting Standards Board
FRRP	Financial Reporting Review Panel
GAAP	Generally Accepted Accounting Principles
GAAR	General Anti-avoidance Rule
IRS	Internal Revenue Service
IT	Information Technology
ITAA	Information Technology Association of America

MAPI	Manufacturers Alliance
MNC	Multinational Corporation
NAM	National Association of Manufacturers
NFTC	National Foreign Trade Council
NIS	New Institutional Sociology
NOL	Net Operating Loss
PCAOB	Public Company Accounting Oversight Board
PE	Permanent Establishment
PM	Performance Measurement
PTP	Positive Tax Planning
PWC	PricewaterhouseCoopers
RM	Risk Management
SEC	US Securities and Exchange Commission
SIA	Semi-Conductor Industry Association
SOX	Sarbanes-Oxley Act 2002
SV	Silicon Valley
SVTDG	Silicon Valley Tax Directors Group
TCPI	Tax Council Policy Institute
TE	Tax Executive
TEI	Tax Executives Institute
TP	Transfer Pricing
USA CIB	US Council for International Business

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Declaration

This is to declare that:

- I am responsible for the work submitted in this thesis.
- This work has been written by me.
- All verbatim extracts have been distinguished and sources specifically acknowledged.
- This work has not previously been submitted within a degree programme at this or any other institution.

Signature: ______________________________

Date: ______________________________

Dedication

For my famous five

Séamus, Aoife, Eoin, Neil and Conor

Abstract

The aim of this study is to achieve a better understanding of tax planning in practice, identifying and taking account of the multiple arenas within which it operates, and thereby highlighting its social and institutional dimensions. In the current rapidly changing business and regulatory environment, in which tax is an extremely important source of revenue for governments around the world, an enhanced understanding of tax planning in practice benefits and has implications for taxpayers and tax policymakers alike. The four research questions posed in this study address: the organisation and strategic alignment of the tax planning function in multinational corporations (MNCs); performance measurement of this function; tax risk management; the nature and impact of the relationship between the tax planning function within MNCs and the external environment within which it operates. Empirically this study focuses on US MNCs, primarily in respect of mainstream corporation tax planning. In line with the interpretive inductive methodological approach adopted, face-to-face interviews were conducted with senior tax executives in US MNCs, and tax advisors to such companies. A theoretical framework is developed which combines core themes and theoretical constructs within three strands of literature, namely, tax planning, new institutional sociology and endogeneity of law. This framework provides a powerful explanatory lens through which the findings are presented and interpreted.

The role of power and powerful actors is an important and recurring theme, and partly explains prevailing tax planning practices through the intensity of professional and social interaction between tax executives. Increasingly tax risk management is more important and there is evidence that this may change the way in which the tax planning function is given strategic recognition and integrated operationally with business units. The focus on tax risk management results in an isomorphic trend towards conservatism in tax planning, and competitor and peer company influence are significant in shaping tax risk management mechanisms. Measuring the performance of the tax planning function is found to be variable, although there was a view that the effective tax rate (ETR), although an important external measure of corporate performance, was inappropriate as an internal measure.

Tax laws are often portrayed as exogenous factors, however this study has found that companies invest heavily in external affairs and direct lobbying to secure changes in the law to suit their purposes; evidencing its endogeneity. Networking costs, reputational risk management and lobbying costs therefore represent non-tax costs that are difficult to measure, but are important components of tax planning activities, overlooked in the current tax planning literature.

In addition to the findings themselves this study contributes to knowledge through its interpretive methodological approach which provides a new and rich perspective on tax planning in practice, highlighting some shortcomings of the positivistic approach. It also develops a theoretical framework which uniquely combines theoretical constructs from three strands of literature.

1 Introduction

1.1 Research Questions

The aim of this study is to achieve a better understanding of tax planning in practice, identifying and taking account of the multiple arenas within which it operates, and thereby highlighting its social and institutional dimensions (Hopwood and Miller, 1994). Following calls in the literature for such a perspective on accounting (Hopwood, 1983) many studies have followed (Hopwood and Miller, 1994). Despite the importance of tax planning for organisations (Mills, Erickson and Maydew, 1998), and the rich social, political and economic context of the tax arena, there has been very little attention given to this extremely important aspect of accounting, which takes an institutional sociological perspective (Powell and DiMaggio, 1991; Meyer and Rowan, 1991; Scott, 2001; Zucker, 1991), as is the way that has been done in this study. This study provides important insights and knowledge on how tax planning is managed, through addressing the practice and process of tax planning, in the context of the internal and external environments within which it operates. This study comes within the accounting research tradition within taxation research,[1] recognising taxation as 'a specialist practice area of accounting' (Lamb, 2005: p.55).[2] Tax is a cost that needs to be accounted for and managed.[3] As noted by Shackelford and Shevlin (2001), 'the literature suggests that financial accounting management and

[1] The terms 'tax' and 'taxation' are used interchangeably throughout this thesis.
[2] See Lamb, Lymer, Freedman and James (2005) for a detailed review of the accounting and other research traditions within tax research namely legal, economic, political science and social policy.
[3]Throughout this thesis the term 'tax' refers to the discipline of tax or the tax department or function within an organisation, as the context requires.

tax management are not independent and neither consistently dominates the other in decision making' (p.327).

Empirically, this study provides a focus on US multinational corporations (MNCs) and is concerned primarily with tax planning in respect of corporation tax namely tax on the income streams of companies, and to a lesser extent indirect taxes.[4] It addresses four specific research questions as follows:

Research Question One: How is the tax planning function organised and conducted in MNCs?

This question is concerned with understanding the organisation of the tax function within MNCs, incorporating the profile of the in-house tax department, the resources at the tax department's disposal, and the relationship between the tax department (through its executives) and other departments, including accounting. This question, critically, is also concerned with the strategic alignment of tax, its embeddedness within an organisation and the principles guiding the tax executives' overall approach to tax planning.

Research Question Two: How is the performance of the tax planning function measured in MNCs?

This question is concerned with establishing what quantitative and qualitative performance measurements are applied in practice to assess the performance of in-

[4] State taxes within the US were not specifically addressed.

house tax executives. It specifically examines the importance and role of a company's effective tax rate (ETR) in this context and the extent to which business units (BUs) are measured on a post-tax basis. This question investigates the process of performance measurement (PM) and its associated problems. The impact of performance measurements and the process applied in other organisations is also examined.

Research Question Three: How is tax risk managed in MNCs?
This question investigates the importance of tax risk management (RM), the types of risks facing in-house tax executives, the mechanisms of tax RM being employed and the extent to which the tax RM process is formalised in MNCs. It is also concerned with understanding the nature and drivers of the tax risk profile of in-house tax executives, particularly in the current context of an increased focus on regulation and corporate governance generally.

Research Question Four: What is the nature and impact of the relationship between the tax planning function within MNCs and the external environment?
This question is concerned with providing an overview of the key organisations and actors that make up the external environment, the 'tax arena', as part of the 'social reality' (Berger and Luckmann, 1966) within which tax executives operate. The influence of the external environment on the practice and process of tax planning within MNCs *and* the influence of in-house tax executives and MNCs in the wider tax arena, including the tax legislature and administration, are of particular interest within

this question. The nature, extent and effectiveness of networking and tax lobbying activities engaged in by tax executives directly and via professional representative bodies are considered.

These research questions were unpacked into a number of objectives within each question which are set out in section 3.2. The remainder of this chapter is set out as follows: section 1.2 describes the background to and motivation for the study; section 1.3 provides a tax and business context for the study; section 1.4 provides an overview of the research design; section 1.5 sets out the contribution of the study; finally, section 1.6 describes the layout of the thesis.

1.2 Background and Motivation

Tax planning is important for many organisations as is partly evidenced in part by research conducted by Mills, Erickson and Maydew (1998). They found a negative relationship exists between investments in tax planning and tax liabilities. Rego (2003) also provided evidence in support of economies of scale to tax planning.[5] Picciotto (1995) posited that '[no] major deal by transnational corporations (TNCs) takes place without consideration of the tax implications and optimal tax arrangements' (p.25). Taxation is an extremely important source of revenue for governments and thus significant political and social importance is attached to it. Indeed, there are many 'players' engaged in tax activities. On the one hand there are taxpayers and tax advisors engaged in tax compliance and tax planning, while on the

[5] Rego (2003) believes her study 'responds to Collins and Shackleford (1999), who cite a lack of empirical evidence regarding the ability of multinational corporations to pay less income tax than domestic-only firms' (p.828).

other hand there are various public servants (i.e. government finance ministers and department officials) engaged in tax policy formulation and implementation. These various players have different objectives but they are all looking to the one tax system with a view to satisfying these objectives. Taxpayers, with the aid of their tax advisors, attempt to engage in effective tax strategies (not necessarily tax minimisation) concerning all aspects of their own businesses. In contrast, tax policymakers, have a much broader range of economic and social objectives which must be met through the tax system. They must also consider the demands of special interest and other constituency groups when formulating tax policy, and endeavour to develop a tax system that has minimal economic distortions. This obvious lack of goal congruence presents opportunities and costs for both sets of players.

Tax legislation, however, is not without its problems. Indeterminate or uncertain tax laws (see section 1.3 which addresses uncertainty of tax laws further) frequently gives rise to exploitation of loopholes in the tax legislation by taxpayers. Such exploitation is usually not unanticipated by the legislature and it amounts to taxpayers working within the law technically but against the spirit of the law. Many tax reduction or elimination opportunities presented to businesses are not planned, or indeed anticipated, by tax policymakers. Exploiting these opportunities, however, is legal and many compliant taxpayers do so frequently. Such compliance exploitation essentially undermines the policy behind the legislation and in itself becomes a problem for policymakers. The response of the tax policymakers, sometimes which may involve introducing more legislation (commonly referred to as anti-avoidance legislation), can be a long, costly, difficult and sometimes ineffective way of implementing desired tax policy. It is also generally not well received by the taxpaying community. If tax policymakers had a better understanding of the practice and process of tax planning within corporations — the subject matter of this thesis — they might be more effective in implementing the desired tax policy.

Such an understanding may also assist tax policymakers in dealing with the rapidly changing technological environment, globalisation and Europeanization. This would encapsulate the need for policymakers to understand the extent to which tax considerations drive business decisions. In support of this viewpoint, Hines (1999), when noting the importance of information on the responsiveness of taxpayers to, for example, worldwide tax rate differences and international tax rules, argues that such responsiveness, 'in turn carries implications for the design of domestic as well as international tax policy' (p.305). There is some evidence to suggest tax policymakers and administrators are interested in understanding business better. For example, the Irish Revenue refers to the need for its goals to be 'rooted in the reality of our business environment' (Revenue, 2003).[6] In the UK, the Inland Revenue has also identified a need for tax inspectors to better understand 'business drivers' and 'to improve understanding of developments in the changing business environment in which multinationals operate' (Inland Revenue, 2001). Such understandings have benefits for both taxpayers and tax policymakers. The Revenue's ability to make

[6] The Revenue in Ireland comes under the ambit of the government's Department of Finance. It is responsible for the tax administration and has some input to tax policy. Its UK counterpart is the Inland Revenue (now Her Majesty's Revenue and Customs following the merger with Her Majesty's Customs and Excise in 2006) and its USA counterpart is the Internal Revenue Service (IRS).

more efficient use of its resources, to anticipate tax avoidance behaviour and products and to more effectively manage the taxpayer thereby ensures that the appropriate Exchequer returns will be enhanced. The taxpayers may enjoy faster resolution of issues, improved tax planning capabilities and greater certainty with regard to future tax liabilities. This study provides important insights and knowledge on tax planning in practice in US MNCs.

My interest in the discipline of taxation developed primarily from my time as tax advisor at consultant and subsequently at manager level with Price Waterhouse, a predecessor firm of PricewaterhouseCoopers (PWC). During this time I provided tax advice to large MNCs on a wide variety of business decisions and this experience has, in part, shaped the focus of the research questions posed in this study. I was always aware of seeing only one side of the picture i.e. the one portrayed to me by the MNC employees I dealt with. On occasions, I was aware that our tax advice was only partly acted on, and sometimes never acted on, but we were not always told why. This gave rise to my interest in seeking to understand the practice and process of tax planning from the MNC perspective. I became very aware of the potential importance of relationships between tax advisors and clients, and, more importantly in the context of this study, between in-house tax executives and their colleagues within their respective own corporations and their counterparts in other corporations and with Revenue officials. As a member of a professional institute (the Irish Taxation Institute), I was acutely aware of tax lobbying activities but only from a tax advisor's perspective. I was always interested in the extent to which MNCs engage directly or through representative groups in tax lobbying and the degree to which such lobbying is considered necessary and effective. As a tax advisor, one can easily overrate the influence of tax on business decisions. I was keen to understand from the client's perspective the role of tax in business decisions, how the strategic alignment of tax with business decisions was managed in practice and, ultimately, why tax seemed to matter more in some MNCs than others.

My subsequent move into academia provided me with the opportunity to consider the above issues from an academic, and arguably, a more objective perspective. It was during this time, through my reading of academic literature and keeping up to date on topical matters within the tax arena, that it became apparent that the areas of tax risk management and performance measurement warranted further study, particularly from the taxpayer's perspective. It was during this time also that I became very aware of the growing recognition that tax policymakers and their administrators need to understand business better, as described above. This study was motivated, in part, by my desire to enhance this understanding and thereby contribute to tax policy formulation and debate.

In addition to the above, as a full-time academic with a strong interest in developing the taxation research agenda, I was highly motivated to undertake this study by the need to make a significant contribution to knowledge when exploring the above areas of interest. This study makes such a contribution in a number of ways as described in section 1.5.

1.3 Tax Context and Business Environment

This section draws attention to a number of contextual matters relating to taxation and the wider business environment within which tax executives operate. They constitute an important backdrop to this study and were taken into consideration at all stages of the study.

Uncertainty of Tax Legislation

It is important to be aware from the outset of the uncertainty of many tax laws. McBarnet (2001a) referred to the fallibility of drafting law, leaving law frequently open to interpretation. Arguably, some uncertainty is intended and some is not. According to Edelman and Suchman (1997) 'the history of regulation is replete with unintended consequences' (p.488). It is this very uncertainty that gives rise to challenges and opportunities for tax executives in business and has explanatory power in terms of understanding some of the findings of this study on the practice and process of tax planning. Such uncertainty or indeterminacy within tax laws is not necessarily a bad thing. For example, Picciotto (1995) posited, when referring to the meaning of company residence for tax purposes that 'key elements of ambiguity as to its scope have provided a flexibility which appears to have suited both the Inland Revenue and corporate tax planners, at least during the period of international economic expansion in the 1950s and 1960s' (p.29).[7] The uncertainty of tax laws is an important and recurring theme throughout this thesis.

[7] In the UK.

Silicon Valley

This study focuses on MNCs based in the Silicon Valley (SV) area of California. This is not a formal geographical area but is understood to encompass the area between San Francisco and San Jose, California.[8] There is a concentration of high-tech companies and service providers to these companies located in the area. Importantly in the context of this study, which draws on NIS, as noted by Kenney (2000), SV 'is indeed a rich prize for social science theories' (p.1).[9] All of the companies in this study are public corporations and the corporation tax system in the US is, as expressed by Slemrod (2005), an 'extra burden' which 'may, at the margin, be a disincentive to being public' (p.92).

Planning Versus Compliance

This study is concerned with tax planning in practice and focuses on US MNCs. As noted in section 2.2.4, there are many references to 'tax planning', 'effective tax planning' and 'international tax planning' which are not explicitly defined. For the purposes of this study, a simple definition of 'tax plan' is provided as '*the tax aspects/structure of any business activity or plan*'. Interviewees who participated in this study agreed with this definition. *Tax planning* refers therefore to any activity or process concerning the consideration of the tax aspects/implications of any business activity/transaction. Tax planning is frequently equated with *tax avoidance* and the

[8] As described in the Silicon Valley Tax Directors Group website: http://www.svtdg.org/

[9] See Kenney (2000) for an informative read on the history of SV, and some observations and explanations around critical institutions and organisational routines for the region.

latter term is frequently associated with exploiting opportunities presented through inadequate legislation. Importantly, however, tax avoidance is not illegal.[10]

It is important to note from the outset that, while this study focuses on tax planning as described above, it became apparent very early on that in-house tax executives are frequently involved in both tax planning and tax compliance work, and have important and insightful views on the definitional differences between planning and compliance, with one interviewee believing the distinction to be, for the most part, 'blurred' (TE 22).[11] While compliance is largely understood to refer to administration (incorporating, for example, data collection and completion and filing of tax returns), interviewees see them as inextricably linked. TE 9 believes 'you kind of have to be involved in the planning sometimes to do the compliance and vice versa'. He posits:

> Really good planning ought to spring in some ways from what you see when you are doing compliance: understanding why you are paying more tax, identifying opportunities to not pay as much tax when you are doing that compliance...Tax planning that is done by people who don't, have never done a tax return for a living and in some cases don't even know what a tax return looks like, often has fatal flaws in it.

TE 24 referred to there being a significant overlap between planning and compliance where the tax personnel are integrated and 'cross-train'. It was not surprising, therefore, to find that in practice, in-house tax departments are not organised along planning and compliance lines. It tends to be based on jurisdiction (e.g. US) or tax

[10] This contrasts with *tax evasion* which is illegal and involves paying no tax or reducing one's tax liability outside the law. I recognise that in practice the concept of 'tax avoidance' is not always simple or certain. Some further discussion takes place on this matter in section 2.2.4. A more detailed discussion of this matter however is outside the scope of this study.
[11] 'TE' denotes tax executive.

speciality (e.g. income tax or sales tax). See section 4.2 for detailed findings on the profile of in-house tax departments.

TE 11 referred to a former boss of his who defined tax planning as 'the ability to change the facts' whereas tax compliance is 'after the facts' or according to his current boss, 'making the best of the facts as they are'. **TE 21** defined tax compliance as 'the sort of day-to-day bread and butter functions that you have to do' whereas planning refers to 'the things that you can do to minimize your tax cost'. The latter would involve, according to TE 7, restructuring, going for advance rulings from the tax authorities, negotiations with foreign governments and so on. While tax compliance was therefore discussed to some extent therefore in the interviews, the focus of this study and the findings as presented in Chapters Four to Seven inclusive are primarily focused on the practice and process of tax planning. Direct reference to tax compliance has been kept to a minimum.

Business and Regulatory Environment

MNCs operate in and typically seek to operate in many different countries, all with different taxation regimes. This presents both challenges and opportunities from a tax perspective as tax executives seek to take advantage of these differences. The range of challenges and opportunities are changing constantly, as is the business terrain within which MNCs are operating. The latter includes a changing economic context (global competition and internationalisation of markets), changing technologies (different ways of doing business), changing management styles and new organisational forms (which may require or give rise to new inter-organisational networks, strategic alliances, outsourcing and so on). In response, James (2005) expects to see increased complexity in tax systems around the globe with continued tax competition between countries and little chance of complete tax systems alignment in the near future.[12] Such complexity, and continued differences in tax systems will, it could be argued, require a more complex and comprehensive response by MNCs which could result in taxation being positioned higher up the corporate agenda. According to James (2005), 'there is likely to remain considerable scope for business strategies to take account of such differences' (p.164).

Focus has also recently been put on taxation in this post-Enron, WorldCom environment, in which Slemrod (2005) posits there is a 'rethinking of the governance of public corporation, and a new set of laws' (p.91), which includes taxation. Consequently, US disclosure requirements have been increased in the areas of public accounting and IRS requirements. One of the most significant changes in this context was the introduction of the 2002 Sarbanes-Oxley Act (SOX), which was referred to many times by the interviewees. SOX constitutes the US federal response to a number of major corporate and accounting scandals including those affecting Enron, Tyco International and WorldCom.[13] This changing regulatory environment brings with it

[12] Despite recent efforts towards tax harmonisation in the EU for example, James (2005) provides evidence to support the view that considerable differences still exists between countries in terms of tax rates and the structure and administration of tax systems.

[13] SOX established new/enhanced standards for all US public company boards, management, and public accounting firms. It also established a new 'quasi-public' agency, the Public Company Accounting Oversight Board (PCAOB), also referred to by many of the interviewees. This Board is charged with overseeing, regulating, inspecting, and disciplining accounting firms in their roles as auditors of public companies. Interviewees were particularly exercised about s.404 of SOX which requires management and the external auditor to report on the adequacy of the company's internal

an era of calls for increasing accountability, resulting in an expected increased focus on areas like RM, and specifically tax RM (see Chapter Six). This study, which has a clear focus on management-type issues (tax strategy development, RM, PM etc.), is certainly timely. Its findings unveil a significant level of consciousness among tax executives of this changing regulatory and corporate governance type environment, and indicates how such a consciousness is penetrating into the practice and process of tax planning.

While a range of tax- related topics or areas of business are referred to throughout this thesis, two in particular warrant a specific mention at this stage as they represent areas which are under regular scrutiny by tax authorities throughout the world, and they both feature in this study as important areas in the context of RM (see section 6.3). The first of these is *transfer pricing*, the 'pricing of business transactions between associated persons' (Miller and Oats, 2006: p.205), such as a parent and its subsidiary. Transfer prices can be manipulated to shift income from one tax jurisdiction (high tax) to another one (low tax). Not surprisingly, tax authorities try to prevent such manipulation and abuse of transfer prices. For the companies involved in this study, which have transactions with many related parties ('associated persons' in the above definition), transfer pricing is an extremely important consideration in a tax-planning context. The second related area to highlight concerns the existence and tax implications of a *permanent establishment*, 'a fixed place of business through which the business of an enterprise is wholly or partly carried on' (Miller and Oats,

control over financial reporting. The latter therefore, requires documenting and testing important manual and automated controls with respect to tax.

2006: p.116)[14]. It includes, a branch, place of management, office and so forth. As noted by Miller and Oats, this concept is 'crucial to the taxation of business profits' (p.115) and is thereby of great interest to in-house tax executives. Generally a state has taxing rights once it is established that a permanent establishment exists in that state. This concept is important therefore in the context of setting transfer prices as referred to above.[15]

1.4 Overview of Research Design

In order to pursue this study's overriding concern with understanding tax planning in practice four distinct research questions were posed. These questions were in turn, unpacked into a number of objectives attached to each question (see section 3.2). These questions and objectives were informed by the literature on tax planning (section 2.2), the conceptual framework (section 3.4) and the findings from exploratory interviews.

After much consideration, an interpretive inductive methodological approach was adopted (section 3.3.1), as it is very well suited to obtaining the insights and understandings about tax planning in practice, which is the subject of this thesis. In line with this overall approach, the face-to-face interview method was the main research method employed. Following a detailed literature review and the

[14] Miller and Oats (2006) draw on the OECD Commentary on the Model Tax Convention for the meaning of 'permanent establishment'.
[15] While 'transfer pricing' and 'permanent establishment' will be referred to throughout this thesis a further focused discussion on them is beyond the scope of this study.

construction of a draft theoretical framework, an interview schedule was drawn up and used as a guide when carrying out the in-depth semi-structured interviews. I carried out these interviews with the heads of tax and/or senior tax managers within fifteen US MNCs in the information technology sector, all based in the Silicon Valley area of California. Section 3.5 sets out the rationale for focusing on these companies and individuals and section 3.6.2 describes the interview process. I also carried out secondary research, namely detailed examination of the companies' 10Ks, their websites, recent company press releases, press comments, and internet-accessible executive biographies of the interviewees.[16] Material on recent legislation, considered to give context to some of the interview discussions was also reviewed, such as the Sarbanes Oxley 2002 Act 2002.

The primary data collected, consisting of interview transcriptions, post-interview notes, and email correspondence received from a number of the interviewees, was analysed with the assistance of NVivo, a well-recognised piece of coding and computer-aided data analysis software (CAQDAS). Section 3.7 describes this process in detail. Following this detailed data analysis process, the theoretical framework was revisited and refined, resulting in the final framework as described in section 3.4. This framework represents the convergence of theoretical explanatory concepts from tax planning literature, new institutional sociology (NIS) and endogeneity of law and is presented in two stages. The first stage (see Figure 3.1), drawing on Dillard et al.'s (2004) framework, sets the scene by encapsulating the three levels of social systems

[16] Form 10K is the annual report that publicly quoted companies file with the U.S. Securities & Exchange Commission (SEC). It provides a comprehensive overview of the company's business.

within which corporate tax executives operate: the economic and political level, the organisational field level and the organisational level. Key actors operating at each level are identified and section 3.4.1.4 describes the dynamics of this framework. The second stage, as represented in Figure 3.2 incorporates the key theoretical constructs drawn from the tax planning literature (for example, income shifting (Scholes and Wolfson, 1992); communication and interpersonal skills (Wilson, 1995)); NIS (for example legitimacy (Scott, 2001; Powell and DiMaggio, 1991); institutional isomorphism (DiMaggio and Powell, 1991b); decoupling (Meyer and Rowan, 1991); power and politics (Perrow, 1985; Covaleski and Dirsmith 1988)); and endogeneity of law (for example the reciprocal relationship between regulated and regulatee (Suchman and Edelman, 1996)). The data analysis and the theoretical framework ultimately formed the platform from which the structure and presentation of the findings chapters evolved (Chapters Four to Seven inclusive).

1.5 Contribution of the Study

This study makes a significant contribution to our knowledge of tax planning in practice. It identifies and fills gaps in the literature, responds to specific calls for this type of research in the literature, adopts an interpretive methodological approach to enhance our understanding of tax planning in practice, advances the development of theoretical constructs through the construction and application of a unique theoretical framework, recognises the social and political influences inherent in tax policy development and implementation, and highlights tax policy implications of the findings, as set out in this section. These contributions serve to uncover the 'black box' of taxation.

This study fills a number of specific gaps in the tax planning literature by addressing a number of aspects of tax planning not previously addressed. For example, in relation to tax strategy, this study provides an understanding of how a strategic role for the tax function is defined, mapped out, implemented, managed and monitored on an ongoing basis in complex, ever-changing organisations. It provides valuable insights into the relationship that exists in practice between tax executives within MNCs and the organisational field (including lobbying and networking), within which it operates, and thereby uncovers the significant impact which members of the that organisational field (for example professional representative bodies) have on the practice and process of tax planning within these companies and visa vice versa.

At an empirical level, this study makes a contribution to the tax planning literature (as reviewed in section 2.2) through the interviews conducted with the 'elites' of tax planning in practice i.e. senior tax executives in US MNCs. Securing access to such individuals is exceptional and the insights gained as a result are equally exceptional. As described in section 3.3.1, the carefully-selected interpretive methodological approach adopted in this research provides a new and rich perspective on tax planning in practice, highlighting some shortcomings of positivistic approaches.

This study contributes to knowledge by directly responding to calls in the literature for this type of research. For example, as noted by Lamb (2005), 'the organization and management of taxation remain research problems that have been little explored' (p.70). Glenn Hubbard referred to 'the paucity of information about the role of tax planning in multinationals' decisions' (Wilson, 1993: p.232)[17]. Roberts and Bobek (2004) called for studies at the organisational level 'to investigate the motivation and execution of managerial strategies that are undertaken to influence tax laws' (p. 587). Hopwood (1983) called for the examination of accounting, of which tax is an important element, in the context within which it operates, recognising the multiple arenas within which it operates and thereby taking account of its social and institutional nature (Hopwood and Miller, 1994). As noted by Hopwood (1983), 'we have a very limited understanding of the forces that either influence accounting change or help to shape the different forms the accounting craft can take' (p.289).

While some of the studies referred to in the tax planning literature review did produce some interesting findings with respect to, for example, to the organisation of the tax function[18], there was no conceptual framework employed for the purposes of constructing/conducting the studies and interpreting the findings. This study makes a significant theoretical contribution through developing a conceptual framework (section 3.4), which (i) provides a rich descriptive framework of the tax arena within which tax planning takes place, drawing particular attention to powerful actors in the

[17] Glenn Hubbard made this comment when recognising the importance of Wilson's (1993) research. Wilson's study was concerned with how taxes influence companies' decisions on capacity expansion (the location decision) and on the use of existing capacity (the sourcing decision).
[18] For example, Porter (1999a), Porter (1999b) and PWC (2001).

organisational field level of analysis, and (ii) uniquely combines relevant theoretical constructs from tax planning literatures (for example Scholes and Wolfson, 1992; Douglas et al., 1996), NIS (for example Powell and DiMaggio, 1991; Meyer and Rowan, 1991; Scott, 2001) and endogeneity of law (for example Suchman and Edelman, 1996; Edelman et al., 1999) literatures. The explanatory power of this framework is in evidence throughout this study as it serves to enhance our understanding of tax planning in practice — the overriding aim of this study. Applying this framework in a tax context, a specialist area of accounting, serves also to develop our understanding of the theoretical constructs themselves contained therein. Scott (2001) posits that institutional theory will 'benefit greatly by continuing to cultivate connections with law and society scholars...,students of society and accounting...All of these communities bring theoretical insights and useful methodologies to our understanding of institutions and institutional change processes'.[19] It contributes to what Edelman and Suchman (1997) refer to as 'the growing literature that discusses the endogeneity between law and organisations' (p.479), which they posit is still at a very early stage and needs to be developed conceptually. This research is a response therefore to Covaleski et al.'s (2007b) call for further research probing 'the institutional pressures by means of the very active agency of political actors who manipulate regulations to serve their own

[19] While three strands of institutional theory have emerged in the literature, namely old institutional economics, new institutional economics and new institutional sociology, a detailed discussion of these three strands is outside the scope of this study. This study is concerned only with the new institutional sociology perspective. See DiMaggio and Powell (1991) and Moll et al. (2006) for a comparison of these three institutionalisms.

interests...and effects of regulators who seek to curb this manipulation through pre-emptive and ex-post orchestration of regulations' (p.38).

Through Research Question Four, this study recognises the social and political influences inherent in tax policy development and implementation. Roberts and Bobek (2004) identify not recognising such influences as being '[a] significant result of the adoption of strict neoclassical assumptions in accounting policy research' (p.565) and they go on to identify 'a strong need for academic research that explores the corporate/state relationship' by addressing collective political influence and strategic political activities of corporations. Importantly, they also highlight that empirical research drawing on the Scholes and Wolfson (1992) paradigm (which takes a microeconomic approach), 'fails to recognize the state as a negotiable contracting party and the structure of tax accounting laws as endogenous to a corporations' tax planning activities' (p.566). (See section 2.2.4 for a review of the Scholes and Wolfson framework and section 2.3.4 for a review of literature on endogeneity of law).

While the tax literature does provide a number of definitions of 'tax planning' (see section 2.2.4), it does not address the extent to which the practice of tax planning is different to tax compliance, nor to what extent in practice they are intertwined in practice. As a by-product, this study explains the distinction/relationship between tax planning and compliance and the impact of this distinction/relationship on the practice and process of tax planning.

Finally, this study contributes by drawing attention to the tax policy implications of its findings, thereby informing the tax policy debate (Shevlin, 1999), through, inter alia, exploring the corporate/state relationship as referred to above and providing information which enhances a State's understanding of taxpayers' motivations and behaviour.

These areas of contribution as identified here are reflected in the substance of the four research questions and associated research objectives as detailed in section 3.2.

1.6 Structure of the Thesis

Chapter Two reviews the pertinent literature from three distinct strands of literature, namely, tax planning, NIS and endogeneity of law. These three strands of literature together inform the conceptual framework developed in this study. Chapter Three sets out the four research questions posed in this study, and their associated objectives. Critical areas of methodology are addressed here, including the overall methodological approach adopted in this study, the research methods employed, interviewee selection, the interview process and data analysis. The theoretical framework and its dynamics are also described in detail in this chapter also. Chapters Four to Seven inclusive present the findings of this study, making theoretical inferences, drawing on the theoretical framework from Chapter Three throughout. These chapters respond to the four research questions posed in this study, highlighting the predominant themes which arose in the detailed data analysis stage. Finally, Chapter Eight summarises the key findings and implications of this study, my contribution to knowledge from this study, and makes some recommendations for further research arising from this study.

2 Literature Review

2.1 Introduction

This chapter consists of a review of three strands of literature, namely tax planning, new institutional sociology (NIS), and endogeneity of law. Core aspects of these literatures are drawn upon to construct a conceptual framework for this study. This framework provides the theoretical lens through which the findings of this study are analysed and discussed in Chapters Four to Seven inclusive[20] (see 3.4 for development of the conceptual framework). Section 2.2 reviews the tax planning literature and is structured on the basis of the key thematic areas of tax and strategy, organisation of the tax function, performance measurement (PM), the technical nature of tax planning and tax risk management (RM). Section 2.3 reviews the pertinent literature on NIS, and is extended to incorporate the role of power and powerful actors in an NIS context. This section also draws upon and reviews the core theoretical insights of the endogeneity of law literature. It concludes by addressing how research in the accounting and taxation domain has drawn on the NIS perspective.

[20] Investigating the practice and process of tax planning could also be carried out drawing on judgment and decision making literature. The latter was given some consideration but was not considered the most appropriate lens to be used in this research. As noted in section 8.4 however, addressing the findings of this study through such alternative theoretical perspectives provides future research opportunities.

2.2 Tax Planning

This section presents a review of the pertinent literature on the nature of tax planning and the tax planning process. It clearly identifies a major 'gap' in the tax planning literature, namely, a need to understand how organisations create, formulate and administer their tax plans. It identifies other 'gaps' in the literature concerning, for example, the area of research methodology. While the literature reviewed is clearly interdisciplinary and comes from a diverse range of academic disciplines (for example, accounting, law, organisational theory), very distinctive themes emerged, which provided the impetus for the structure of the literature review presented here. Many aspects of this literature were drawn upon when constructing the interview schedule, and will be revisited in the course of analysing the findings.

2.2.1 Tax and Strategy

This section reviews the literature which is concerned with tax strategy and its alignment with overall business strategy. This includes addressing the importance of tax within organizations i.e. the embeddedness of tax. There is no overall consensus on how important tax actually is in organisations. For instance, Porter (1999a) reported that just over 50% of tax managers surveyed 'believe their company's directors accord "considerable" or "very great" importance to minimising tax liabilities' (p.36). There is some debate in the literature about the role of tax in business decisions, the extent to which tax personnel should be consulted when business decisions are being made and what types of business decisions merit a tax input. Wilson (1995) questions therefore whether an in-house tax professional is perceived as a 'tax policeman', 'service provider' or 'business partner'.

The tax literature is not, however, short however of advocates of the strategic importance of tax. Valente (2002) posits the 'strategic alignment of the taxation variable with the goals pursued by top management' as representing 'the most forward-looking approach within the multinational entrepreneurial scenario'. He notes that globalisation has tax implications from both the perspective of states and enterprises. It presents the former with obstacles and challenges but the latter with new opportunities. He sees the strategic vision for taxation policy within multinational groups as taking place on a global scale and is 'consequently implemented (on a corporate level) in a transnational spirit, to the primary benefit of the country in which the top holding resides'. According to Hines (1999), '[i]nternational tax rules and the tax laws of other countries have the potential to influence a wide range of corporate and individual behavior' (p.308), and he continues 'there is considerable evidence that tax considerations strongly influence the choices that firms make' (p.313).[21] Picciotto (1995) posited: 'No major deal by transnational corporations (TNCs) takes place without consideration of the tax implications and optimal tax arrangements' (p.25). Yancey and Cravens (1998) alluded to the importance of a company's tax strategy complementing and thereby having a role to play in implementing a company's overall business strategy. Karayan and Swenson (2007) posit that 'good decision makers generally seek to manage taxes on every major transaction' (p.7) and that tax management should 'work to enhance

[21] When structuring and financing investments, related parties' transactions and profit distribution.

the firm's strategy and should not cause the firm to engage in tax-minimising transactions' (p.63).

Notwithstanding the above, James (2005) highlights the 'pervasive nature of taxation in commercial transactions' (p.154), when making the case for incorporating taxation into business strategy and calls for consideration of economic, legal and accounting aspects of taxation when including taxation in the process of developing business strategy. He expresses some surprise therefore that 'there are textbooks on business strategy that hardly mention taxation' (p.154), Glaister and Hughes (2008) point out that 'in general, models which set out the prescriptive approach to strategic management make no reference to tax implications of strategic decisions' (p.34). The dearth of consideration of tax issues in the strategy and management literature contributes to the 'black box' status of tax. Interestingly, James (2005) does not focus on the inclusion of tax in this context as a technical tax exercise but as a 'process of incorporating tax considerations regarding present and likely future tax developments along with all the other relevant factors in strategic business decision making' (p.164). Similarly, Holzman (1965) believes that most management decisions have tax consequences which should be addressed, and the management group must 'know enough about taxation to solve the organizational, commercial and financial problems that have to be met' (p.6). The latter emphasises the importance of effective communication and relationships skills, which are at the core of Wilson's (1995) efforts to find ways to have senior management and in-house tax personnel work together towards optimisation of after-tax profits.

Porter (1999a) refers to prior research in the investment/fund management area which concluded that shareholder value analysis is the single most useful technique for valuing and appraising a company. This research also found that a company's cash tax rate is one of the most important drivers of shareholder value. It follows therefore that 'managing cash tax liabilities to gain maximum financial advantage should be a key corporate objective' (p.32). This gives rise, she argues, to two divergent components i.e. tax compliance and planning. There are definitional issues concerning 'compliance' and 'planning' which have implications for organisation of the tax function in MNCs which would question the extent to which these could be considered 'divergent' in practice (see sections 1.3 and 4.2).

PWC (2001) found that internal marketing of the tax function to colleagues in other functions is an important task in the context of the tax function helping to implement an organisation's corporate strategy. These colleagues are like customers and should be supported through seminars, training and road shows. They refer to an increasing interest in the tax function at Board level arising from an awareness of 'the contribution that effective tax planning can make to corporate strategy' (p.3). KPMG (2005) set out to 'stimulate further discussion at board level as well as below and help tax, its oversight and management, be responsive to industry preferred practice developments in an ever changing world' (p.1). The latter, of course, is evidence of tax practitioners trying to push tax on to the Boardroom agenda.[22] This research investigates further the factors which influence the perception of tax within MNCs and the resultant real impact of tax on the way business is done.

PWC (2001) found that most tax directors' focus was still on the larger strategic plan but that they would like to increase dialogue with the business units. Tax directors said the people they need to influence mostly are the finance directors and CEOs. They must get Board approval on for things before getting them accepted at operating level (some said the former is sometimes easier). This study investigates the current level and drivers of interaction between tax and the Board. As noted by Glaister and Frecknall Hughes (2008), there are some unanswered questions including 'how within the firm strategic decision-makers interface with tax decision-makers' (p.34).

The extent to which tax is embedded strategically in organisations could also be a function of the size of the organisation, with Rego (2003) positing that 'large firms generally engage in more business activities and more financial transactions than small firms do, thereby providing more opportunities to avoid income taxes' (p.812). The size of the companies that participated in this study was a factor to be considered when engaging in purposive sampling (see section 3.5). There is a counter argument however, as also acknowledged by Rego (2003) also whereby 'proponents of the political cost hypothesis argue that larger firms are likely to pay *more* income taxes

[22] I acknowledge the vested business interests of tax advisors in this context. This is not only a US phenomenon, see KPMG (2005) Tax in the Boardroom: A Discussion Paper, and HMRC Tax in the Boardroom (http://www.hmrc.gov.uk/lbo/tax-in-the-boardroom.htm).

than smaller firms do, as a result of increased visibility and government scrutiny and expropriation of resources' (p.812)[23]. My study addresses various aspects of the external political tax environment including the process of engaging with it, and the potential costs/benefits of such engagement (Research Question Four).

While there is some consensus in the literature that tax should be strategically important, and yet that it sometimes struggles to really matter greatly in practice, none of the research has gained a real understanding of how a strategic role for the tax function is defined, mapped out, implemented, managed and monitored on an ongoing basis in complex, ever-changing organisations. Also this literature fails to examine the formalisation (or not) of an overall tax strategy/mission within MNCs, and the factors which establish the importance of tax (tax embeddedness) within these organisations. This includes, for example, the role of key players such as the CFO, the extent to which tax is integral to the way business is done within MNCs, and the extent to which tax personnel understand and/or are enabled to understand the business within which they are operating.

2.2.2 Organisation of the Tax Function

An obvious question for all organisations, particularly large organisations, is how best to organise the tax function. The tax function comprises compliance and planning both of which are referred to in this context. Decisions concerning whether to have an in-house tax department, whether to outsource some or all of the tax function and the

[23] Zimmerman (1983) discusses the 'political cost hypothesis' in detail.

extent to which external advisors should be consulted are among the key considerations addressed in the literature.

PWC (2001) found that as complexity increases, tax directors must establish clear responsibility for direct and indirect tax compliance and support in overseas territories and ensure those reporting lines are briefed on tax issues. Responsibilities for overseas territories are expected to be of great relevance and importance to the companies involved in this study due to their presence in so many countries, all with different tax regimes and different tax risk exposures.

An important aspect of organisation of the tax function concerns the decision around outsourcing. Levine and Lerner (1993) discuss the opportunities and challenges for the corporate tax executive arising from outsourcing the tax function or even considering outsourcing it. They see the climate of discussion on outsourcing as a wake-up call for the tax executives within companies and it should be seen as an opportunity for the tax section to highlight the value added by them and the many benefits they provide, which is at least in part, a function of good communications between the tax executives and management generally. They also refer to the importance of good communication and open dialogue between the tax executive and the auditor. According to Levine and Lerner (1993), the in-house tax executive must be able to combine technical competence with 'an understanding of the corporation's goals...ongoing experience with the myriad personalities involved...knowledge of the company's practices...and appreciation of the corporate culture that enable the tax executive to bring more to the table than the outside consultants'. The tax executive should also show CFOs and CEOs the advantages of evaluating operating units on an after-tax basis. The latter would obviously lead to operating managers becoming more interested in tax considerations, which would make them more open to involving the tax department.

In the climate of outsourcing non-core business areas, Levine and Lerner (1993) advocate that the corporate tax executive should try to 'transform the tax department from simply a service department into a strategic resource for management'. Essentially, tax executives should try to outsource the compliance-related work and spend more time on 'generating tax planning ideas, reducing effective tax rates, and improving after-tax profitability of specific business units and the organization overall'. They call for the application of performance improvement methodologies for tax departments to achieve advantages.

Dunbar and Phillips (2001) produced some interesting findings when testing for relationships between a number of organisational and environmental factors, and the organisation of the tax function in terms of it being outsourced or managed in-house. For example, they found that tax is not outsourced when top management perceives the interaction between tax professionals and operating managers to be important[24]; companies that generate proprietary technology[25] do not tend to outsource the tax

[24] High importance was deemed in evidence where operating managers were assessed on an after-tax basis.
[25] Measured by investment in research and development.

function; larger firms tend to outsource less than small firms; evidence did not support the idea that companies with a wide range of activities are more likely to outsource the tax function; growth firms outsource more and where tax professionals are of a high status within the company they are less likely to outsource the tax function.

Porter (1999a) presents the results of a 1996 Price Waterhouse survey of the in-house tax function of various UK companies. Overall, it was suggested that in-house tax executives could add more value by spending more time on tax planning and advisory work. They should 'focus on tax planning (with a view to maximising tax benefits and minimising tax liabilities) and giving general tax advice within the organisation' (p.50). Wilson (1995), whose research also addressed the matter of tax adding value, posits that tax professionals can add value by having and indeed always improving on three kinds of human capital: business knowledge, tax expertise and relationship skills. He also emphasises the necessity of organizational support by, for example, providing incentives, resources and opportunities for tax personnel.

Clearly, companies use external advisors to various degrees and with various degrees of success. They are typically employed to help out with excess workloads and/or, generate, confirm, provide, comfort, reassure, or consult on tax planning ideas or proposed transactions, specialist knowledge (technically/territorially), and compliance. External tax advisors, important actors in the tax organisational field (see section 3.4), are typically placed in accountancy or legal firms. It is argued that 'lawyers have greater independence and can offer a more creative approach...Lawyers can also offer client confidentiality' (Picciotto, 1995: p.26).[26] According to PWC (2001), 'most interviewees consider the Big Five advisers "essential" for management of international tax profiles because of their extensive international networks'.[27] In order to ensure consistent quality throughout the group, responsibility for appointing external advisors should be centralised.

While the PWC studies provide some interesting findings on tax organisation issues there was no conceptual framework employed for the purposes of constructing/conducting the studies and interpreting the findings. Theoretical implications were not addressed. Also, the Dunbar and Phillips (2001) study produced some interesting findings but due to the quantitative nature of this research these findings are largely unexplained. It is necessary to go beyond these findings and seek to understand, for example, in what way does a tax professional's in-house status effect the out-sourcing decision? What strategic role can tax play when it is outsourced? Addressing these types of questions, as is done in this study, provides a deeper understanding of the organisation of an MNC's tax function.

Finally, the tax literature does not address directly the extent to which the practice of tax planning is different to tax compliance as perceived by in-house tax personnel,

[26] Literature on the professions, for example Abbott (1988), was considered, but deemed not to provide an appropriate theoretical lens for the purposes of this study.

[27] The 'Big Five' providers of accountancy and taxation services worldwide at the time, consisted of Price Waterhouse (now PricewaterhouseCoopers), Ernst and Young, Deloitte, KPMG and Arthur Anderson. Since the demise of Arthur Anderson, the other advisers are now referred to as the 'Big Four'. Again, I recognise the vested business interest of PWC in this context.

nor to what extent in practice are compliance and planning (however defined) intertwined. This study obtains the participants' view of the distinction/relationship between tax planning and compliance and the impact of this distinction/relationship on the practice and process of tax planning, which ultimately impacts on the organisation of the tax function in MNCs (see sections 1.3 and 4.2).

2.2.3 Performance Measurement[28]

Measuring performance of tax professionals in organisations (as in other disciplines) can be contentious, problematic and varied. Factors often looked at include the effective tax rate (ETR)[29], the cash rate and the accounts rate. However, PWC (2001) found very little uniformity on the way tax directors are appraised, and that tax directors were frustrated with this lack of 'specific and achievable targets'.

In terms of who evaluates the tax function, which incorporates the in-house tax executives, collectively referred to here as 'tax', Douglas and Ellingsworth (1996) suggests CFOs are the principal evaluators, presumably explained by the likelihood that tax typically sits in the finance division. PWC (2001) say 'the tax function is perhaps the hardest function to evaluate within an organisation' (p.25). They suggest using some combination of the following measures: minimisation of penalties;

[28] A literature review on the use of financial and non-financial performance measures, and performance management in the non-tax related accounting literature was beyond the scope of this study (for example, Otley (1997); Ittner and Larcker (2003); Otley (2003); Cavalluzzo and Ittner (2004)).
[29]The working definition for ETR in this study is: provision for income taxes/income before tax provision. This provision is a combination of the tax liability (which includes reserves) and deferred taxes as per the accounts. This definition of ETR is in accordance with one of the definitions put forward by Scholes and Wolfson (1992: p.148) which they posit is popular for financial reporting purposes. According to Rego (2003), 'the usual definition of ETRs is income taxes currently payable divided by pre-tax accounting income' (p.811). My calculation of ETRs included in Appendix 6 is based on this definition.

reduction of interest on overdue tax; project team feedback; structural savings identified; number of initiatives adopted by the group; successful peer review; negotiated settlements with Revenue Authorities;, potential exposure versus agreed amount. Porter (1999a) referred to similar performance evaluation techniques. Douglas et al., (1996) referred to 'traditional' performance measures being in place such as tax audit results and meeting compliance deadlines, but added that broader-based measures such as providing superior customer service and 'increasing value to the business enterprise...appear to be the real world measures by which the performance of the tax department and its executives are judged'.

In relation to the ETR, it is noteworthy that many researchers have used it to attempt to measure the effectiveness of tax planning such as Zimmerman, 1983; Mills et al., 1998; Rego, 2003. According to Rego (2003), 'ETRs have been an important measure of corporate tax burden for policymakers and academic researchers for several decades' (p.809). It should be handled with great caution however in this context because, as pointed out by Phillips (2003), '[a] lower ETR, however, can only proxy for tax savings and does not always imply that after-tax income and/or cash flows have been maximized' (p.848). In Slemrod's (2005) discussion of the pros and cons of increasing disclosure of some tax return information, he suggests such disclosure might well 'exacerbate the race to the bottom of ETRs' (p.95). More interestingly however, he poses the question as to where shareholders think lower ETRs come from. While in part, it may be because some corporations have smarter tax personnel, he adds 'savvy investors realize...that lower ETRs result from a more aggressive stance that pushes the limits of what is legal' (p.95). The latter has clear implications in terms of PM, and the question beckons as to whether corporations who reward the lowering of the ETR are simultaneously advocating or encouraging an aggressive tax approach which may not always be in the best interest of other stakeholders, including shareholders. A real sense of the extent to which the ETR exercises the minds of senior tax personnel within these MNCs is provided in this study (section 5.3). Interestingly, Scholes and Wolfson (1992) believe that ETRs lack real economic meaning.[30]

As posited by Rego (2003), 'ETRs are an important measure of performance to a diverse set of stakeholders' (p.809). Such other stakeholders include financial analysts, identified as important actors in the tax organisational field (section 3.4). Rego (2003) asserts 'the widespread interest in ETRs suggests that ETRs have valuation implications' (p.809). In relation to the forecasting of ETRs, for example, Bauman and Shaw (2005) found that 'although interim ETRs are useful in predicting future earnings, both financial analysts and stock market investors fail to fully impound the earnings implications of interim effective tax rate changes in their decisions' (p.57). Underlying this type of research is the assumption that ETRs do matter because financial analysts do to some extent monitor them and question Chief Financial Officers (CFOs) about them. It would be reasonable to expect therefore some cognisance being given in practice to the ETR in terms of performance

[30] This is largely because the two ETR definitions put forward by these authors do not take account of implicit taxes, which they go on to acknowledge are difficult to measure in any event and are therefore typically excluded from studies on corporate tax burdens.

measurement, not least because it is a measure easily comparable (by the analysts and others) with other companies. This research investigates the perceived importance of the ETR as a performance measure among tax personnel and of what it indicates to analysts (if anything) about the company's performance. As outlined by Bauman and Shaw (2005), under APB No.28[31] these companies estimate the annual ETR when making their interim (quarterly) income tax provision, and this estimate is audited which thus automatically merits it further attention. This is then public information, and it would be reasonable to expect that meeting this predicted ETR in itself may in itself well become an objective which translates into a measure of performance. Significant movements away from the predicted ETR may then need to be explained to the CFO/by the CFO and ultimately to the financial analysts. The use of any measure like this, where potential impacts on share valuation could be realised, might suggest some earnings-management-type activity might be engaged in, in order to meet the forecast (in order to prevent the potential negative market response).[32] As suggested by Bauman and Shaw (2005) 'firms might use APB No. 28's flexibility to manage reported earnings to meet earnings thresholds' (p.58). While prior research has been carried out concerning ETRs in the context of earnings management and compensation-based incentives (for example, Bauman and Shaw, 2005; Dhaliwal,

[31] APB Opinion No.28, Interim Financial Reporting. The Accounting Principles Board (APB) is the former authoritative body of the American Institute of Certified Public Accountants (AICPA). It issued pronouncements on accounting principles until 1973. The APB was replaced by the Financial Accounting Standards Board (FASB).

[32] Addressing the earnings management literature in this context is beyond the scope of this research, but I was interested to see how the interviewees perceive the importance of ETR in terms of performance measurement (such perceptions one might expect to feed into how tax personnel connect with/engage with the ETR) and its interpretation by financial analysts, which ultimately could impact on share valuation.

Gleason and Mills, 2004;[33] Phillips, 2003), the literature lacks any qualitative interpretive approach to this topic as in the way that is adopted in this study.

When measuring performance one benchmark often used is often that of the competitors. This is particularly applicable with respect to ETRs. An agreed definition of ETR, which exists based on this study (see footnote 29 and section 5.3), renders such benchmarking possible. Increasing public disclosure requirements in terms of items like tax liability and taxable income might, according to Slemrod (2005), 'facilitate incentive contracts for tax managers by making it easier to benchmark their performance against the performance of Tax departments in the same sector' (p.95). In my study, Research Question Three investigates matters such as the extent to which benchmarking among competitors does actually take place. Does it matter? What aspect of tax lends itself to benchmarking? How difficult or easy is the benchmarking process? The US corporate tax rate provides another possible benchmark for assessing a company's ETR. Karayan and Swenson (2007) support the idea that US MNCs do actively manage their taxes by comparing the relatively low effective tax rates of a number of MNCs with the standard US corporate tax rate of 35%. This study enhances our understanding of the practice and process of such active management.

[33] Interestingly, they believe that tax is a suitable context for studying earnings management because it is 'one of the last accounts closed before earnings are announced because other income related changes affect the tax accounts' (p.435).

A contentious area within the PM of tax context concerns assessing the performance of non-tax staff on a post-tax or pre-tax basis. Arguably, if a post-tax basis is used, tax may well be given more attention by non-tax personnel which, ultimately, might result in them incorporating tax implications into their business decisions. The latter approach however may, however, be contested by 'tax experts' who posit the view that consideration of the tax implications and subsequent management thereof should be left to the experts in the field. Phillips (2003) reasonably suggests that using the ETR as a measure should motivate 'the manager's increased cooperation with tax professionals to help identify, develop, and execute tax-planning strategies' (p.849).[34] Wilson (1993) refers to the problem for corporate managers of trying to 'ensure *after-tax* profit maximization when sourcing managers are evaluated *pretax*?' (p.226). Phillips (2003) does however acknowledge however one potential shortcoming in his study in its not taking into account costs associated with using after-tax performance measures.[35] Dunbar and Phillips (2001) did find companies that assessed their operating managers on an after-tax basis (as referred to above). Subsequently, Phillips (2003) used the ETR as an empirical surrogate for tax-planning effectiveness, when investigating if compensating business unit managers and chief executive officers (CEOs) on the basis of after-tax accounting based performance measures leads to lower ETRs. He found that compensating business unit managers only on an after-tax basis leads to lower ETRs. Phillips (2003) refers collectively to a number of studies in this area which found that 'multinational status, number of operating segments, firm

[34] Examples of such cooperation would include early consultation with the tax department about plant location decisions or new employees coming on board.
[35] These costs would include additional wages, administration costs and possibly increased scrutiny from the tax authority.

size, and capital intensity are positively associated with after-tax CEO compensation' (p.850). Companies presenting with these attributes would arguably be best positioned to engage in and exploit tax planning opportunities. KPMG (2005), recognizing that pre-tax PM still predominates, make the logical statement that 'generally speaking, managers are not motivated by their assessment and reward systems to take tax into account in their day-to-day decision-making' (p.4). In Wilson's (1993) study only two of the nine companies involved used after-tax evaluation systems. Again, however, most prior studies take a quantitative approach, and there are many potential measurement issues associated with the various variables/proxies used in such studies, many of which are acknowledged by the authors themselves.[36]

2.2.4 Technical Nature of Tax Planning

There are many references in the literature to 'tax planning', 'effective tax planning' and 'international tax planning'. However, such terms are often not explicitly defined. For the purposes of this study, it is useful, and indeed necessary, to provide a simple definition of what is meant by the term 'tax plan'. It is defined as *'the tax aspects/structure of any business activity or plan'.*[37] This simple definition refers essentially to the organisation of a business activity/transaction from a tax perspective. It thereby considers the tax implications of any business

[36] Wilson (1995) did however, as part of a working paper carry out a number of interviews which included discussion on this point.

[37] After conducting some exploratory interviews I felt this short definition was appropriate and necessarily broad to capture the many and varied transactions/activities that could be legitimately categorised as 'tax planning', as well as incorporating the various aspects of tax planning reflected in this section of the literature review. Interviewees agreed with this definition.

activity/transaction. As mentioned earlier, the literature does not address directly the question of differentiating tax planning from compliance. This differentiation, and its implication for the practice and process of tax planning, is addressed in sections 1.3 and 4.2. In this section of the literature review no further reference will be made explicitly to compliance.

A number of distinct perspectives on tax planning can be drawn from the literature, although there are clear points of overlap with respect to certain principles. Scholes and Wolfson (1992) provide a framework for understanding how taxes affect decision making, asset prices, equilibrium returns and the financial and operational structure of firms.[38] This facilitates examining an examination of the impact of taxes on business activities generally. According to Macnaughton and Mawani (2005), it 'seeks to explain the role and influence of taxes in organizations in a positive and predictive approach' (p.168). They point out that research resulting from this framework has become labelled as the 'microeconomic approach to tax planning' (p.168). Such research typically uses the tools of modern finance and economics, and is chiefly concerned with the implications of tax rules for individual and firm behaviour. Scholes and Wolfson (1992) posit that effective tax planning requires the consideration of all parties, all taxes (both implicit and explicit), and all non-tax costs in connection with any business transaction. As noted by Wilson (1993), who drew on the Scholes and Wolfson framework, 'tax planners must sometimes sacrifice tax

[38] This 1992 edition comprises the pioneering work of Scholes and Wolfson on this framework, and is therefore referenced throughout this thesis. Two subsequent editions have since issued in 2002 and 2005, to which the authors Erickson, Maydew and Shevlin have been added. There are no significant amendments made to the framework in these subsequent editions.

benefits because of nontax considerations...tax planning is subordinate (as a managerial objective) to maximizing firm value' (p.196). He specifically identifies some non-tax considerations or 'frictions' in a company-location decision context as including 'technology constraints, transportation costs, company culture, the need to be close to customers, and the need to concentrate manufacturing in a few world-scale plants to compete on costs' (p.198). Other non-tax costs for consideration generally include financial reporting costs, transaction costs and agency costs.

Scholes and Wolfson (1992) are primarily concerned with tax planning activities from the perspective of tax rules, so it is not surprising that Shevlin (1999) sees tax planning research as examining 'how firms and individuals respond to the tax rules...How do the tax rules influence how businesses and individuals conduct their lives?' (p.430) This perspective, which works largely on the basis that law is determinate, (see later in this section where this notion is challenged), has resulted in the pursuit of a quantitative approach to tax planning research which fails to take into account many other influencing factors on a company's tax planning activities apart from the tax rules themselves. In addition, as noted by Roberts and Bobek (2004), the Scholes and Wolfson paradigm 'fails to recognize the state as a negotiable contracting party and the structure of tax accounting laws as endogenous to a corporation's tax planning activities'(p.566). This endogeneity of law construct constitutes an important part of the extended NIS theoretical perspective put forward in this study (see sections 2.3.3, 2.3.4 and 3.4.2).

Yancey and Cravens (1998) are equally concerned with all taxes and non-tax costs. 'An effective tax policy must integrate all relevant taxes and consider the effect to the overall corporate entity in conjunction with non-tax constraints' (p.252). James (2005) refers to conflicts which may arise between tax and financial reporting, a non-tax cost. Karayan and Swenson (2007) allude to lobbying costs as a non-tax transaction cost to be considered. This study investigates the nature of non-tax costs that tax executives have to deal with in practice.

Scholes and Wolfson's (1992) perspective on the tax authority in this context is an interesting one, describing it as an 'uninvited party to all contracts' and an 'investment partner'. According to Karayan and Swenson (2007) managers should aim to minimise that particular partner's (the tax authority's) share of the firm's value-added. Scholes and Wolfson (1992) and James (2005) identify the need for dynamic tax planning which includes reversibility and adaptability in responding to subsequent changes in tax rates, laws and many other developments. Hoffman (1961) refers to the existence of loopholes actually making tax planning more effective, while McBarnet (2001b) refers to the law being treated as 'recipes for avoidance'. Scholes and Wolfson (1992) posit that changes in all tax regimes (US and non-US) involve turning two kinds of 'dials', namely, levels of tax rates and relative tax rates (across tax paying units, tax periods and across economic activities). As the 'dials' move (i.e. as the tax rules change) their framework could facilitate gaining an understanding of how businesses reorganise their business activities in response to the dials turning.

Scholes and Wolfson (1992) identify three types of tax planning which engage tax planners: converting income from one type to another,[39] shifting income from one pocket to another,[40] and shifting income from one time period to another.[41] Samson (1998) also referred to these as three basic tax planning strategies, which he endeavoured to have his students grasp.[42] Fallan, Hammervold and Gronhaug (1995), in their research on tax planning in the context of innovations literature, also refer to these three tax planning strategies. Taxpayers who know about these 'innovations' and their impact on the tax burden will adopt them and subsequently make money. Green (1999) sees the identification and evaluation of tax planning opportunities as 'an important part of risk management' (p.146).[43] Where any of the above activities do not exhibit a 'valid business purpose' other than tax avoidance, the tax authority may well recharacterise the activity and such a recharacterisation will result in a less favourable tax treatment.[44]

Hoffman (1961) looks at tax planning from the tax practitioner's perspective, and identifies seven cardinal principles that are 'inherent in every tax planning process' (p.274). These are: flexibility, personalisation, a professional product, coordination,

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[39] For example, converting income to capital gains which carries a more favourable tax treatment.
[40] For example, a high tax bracket taxpayer having income earned through a tax-exempt pension fund.
[41] For example, delaying income recognition until a future lower tax rate period.
[42] Samson (1998) applied historical tax rates in eleven different scenarios to help his students grasp these three tax planning strategies.
[43] See section 2.2.5 for further discussion of tax risk management.
[44] See section 1.3 on distinction between tax avoidance and evasion.

resolution of conflicting interests, orientation as to time and complete honesty.[45] While clearly an advocate of a formalised approach to tax planning, he reminds us that effective tax planning 'can never be the sole objective of the taxpayer' (p.276). Karayan and Swenson (2007) are advocates of a transactions approach to tax management, utilising the SAVANT framework which considers strategy, anticipation, value-adding, negotiation and transforming' aspects of any transaction being considered (p.63).[46]

In contrast, Yancey and Cravens (1998) constructed a tax planning framework for MNCs concerning specific areas of jurisdiction, time periods, choice of entity, contractual forms, and corporate activities,[47] all of which require serious attention from a tax perspective in order to minimise worldwide taxes.[48] Like Scholes and Wolfson (1992), this framework assumes MNCs endeavour to minimise their tax exposure subject to non-tax constraints. Interestingly, Yancey and Cravens (1998) are of the view that MNCs should, when engaging in tax planning, 'evaluate tax policy goals of foreign governments and method of collection for each firm where the firm maintains operations'(p.270). The role of bilateral tax treaties need to be considered

[45] While his views in this article pertain largely to personal taxes they are equally applicable to a wider business tax planning context. There is a significant overlap between these principles and the Scholes and Wolfson (1992) framework, signifying to some extent how little things have changed over time concerning the principles of effective tax planning.
[46] Many aspects of this model overlap with the Scholes and Wolfson framework. For example, negotiation incorporates negotiating with other parties to the transaction and perhaps with tax authorities.
[47] Corporate activities would incorporate the provision of services both within and outside the MNC group.
[48] The Yancey and Cravens framework was applied to a hypothetical company and was not tested therefore empirically on a database of companies (which is in contrast to studies based on the Scholes and Wolfson framework).

here also, as does the tax administrative process in each country. Karayan and Swenson (2007) similarly refer to the importance of anticipating tax changes before they become official. The latter suggests the need for MNCs to monitor closely — and indeed take into account in their tax planning — how tax policy in various countries is formulated and implemented.

Another perspective on tax planning in the literature is a purely legalistic one. In this context tax planning is frequently equated with tax avoidance (see also section 1.3). The latter is largely concerned with the idea that tax planning amounts to exploiting opportunities presented through inadequate legislation. Tax avoidance is not, however, illegal. Slemrod (2005) calls attention to studies that document a gap between book-reported income and taxable income of corporations, which is not fully explained by accounting differences. The latter, he suggests 'has prompted some observers to conclude there is growing tax avoidance' (p.93). McBarnet (2001b) is of the view that such 'creative compliance' can in practice 'frustrate tax policy', and is 'pervasive among leading lights in the social and corporate world' (McBarnet, 2001a: p.5). She sees tax avoidance as a 'creative' way of complying with the strict letter of the law but often 'undermining the policy behind the words' (2001b, p.2) i.e. it is outside the spirit of the law. Porter (1999a) defines *positive tax planning* as 'the deliberate use of techniques which may contravene the spirit but not the letter of the law, with a view to reducing the company's tax liabilities' and distinguishes it from 'good housekeeping' (p.47). According to McCahery and Picciotto (1995), such legal creativity 'raises constant ethical, political and economic (as well as legal) issues, as it probes the limits of existing regulatory patterns' (p.259).[49] McBarnet (2001b) posits that creative compliance is a 'general law issue' and accordingly she sees the chance to learn from similar creative compliance issues in other disciplines, particularly accounting. McBarnet and Whelan (1992) earlier addressed the area of accounting and the law. The question they posed was 'Could the might of the law lead to more effective control of accounting?' (p.101). With regard to ineffectiveness of law in various areas they refer to two factors which have dominated socio-legal research i.e. the failure of the lawmakers and the failure of law enforcers. These authors introduce a third factor, 'the role of the regulated in actively resisting it' (p.102). (See section 2.3.4 for some discussion of the overlap between this literature and the endogeneity of law perspective.). They conclude that 'there are fundamental limits in the nature of the law itself' (p.102), and acknowledge that even when law is changed to close some 'loophole' another way of working around it is found. They question therefore whether the law can in fact 'control creativity'. Indeed, 'it is the indeterminacy of the abstract rules that leaves the space for creativity, which enables the reshaping of the regulatory regime' (McCahery and Picciotto, 1995: p.266). Burton (2007) questions any presumption that law is determinate in the face of considerable uncertainty in the application of tax rules.

McBarnet (2001a) identifies two factors which contribute to creative compliance.

(i) Drafting law is *'fallible'*. It is difficult to get right all the time and the nature of law is that it is often open to interpretation.

[49] See this article for a detailed addressing of philosophical concerns arising around the question of 'compliance' with rules and 'creativity' in relation to those rules.

(ii) Some people see the law as 'material to be worked on to one's own or one's client's interests' (p.3). There is this type of *attitude* to the law that lends itself to creative compliance activities. This assumes essentially a disregard for the policy behind the legislation, similar to Scholes and Wolfson (1992).

McBarnet (2001a) sees creative compliance actively seeking out opportunities under three headings:

- *Gaps* in the legislation i.e. the 'where does it say I can't do that?' argument';
- The *ex-files of law* i.e. restructuring practices to fit within express exemptions, exclusions and exceptions;
- *Rules* i.e. adopting legal forms to fit inside or outside the literal interpretation or ambit of the prescribed rules.

McBarnet (2001a) mentions that creative compliance is legal/illegal depending on the outcome in court, but if found to be illegal in this context it may still not be branded a tax fraud. McBarnet (2001b) discusses the advantages and disadvantages of a shift away from strict tax rules and regulations to principles, considering the substance of practice as well as its legal form, introducing 'super-principles' such as the general anti-avoidance rule (GAAR) and taking a conceptual approach to the construction of definitions.[50] Such general anti-avoidance provisions should prevent taxpayers 'arranging their affairs "artificially" to avoid tax' (James, 2005: p.158). However, McBarnet (2001b) still maintains such principles can be treated as 'material to work

[50] See 2.2.5 for further reference to GAAR.

on' and presents opportunities under the three headings referred to above. Interestingly, and perhaps somewhat worryingly, Picciotto (1995) posits:

> Regulation based on bargaining within the framework of broad discretionary rules can be functional if there is sufficient understanding and acceptance of parameters between the players, that is, if there is a relatively small universe of 'repeat players', perhaps socially homogenous or operating within a shared professional ideology. (p.36)

He goes on to state that dysfunctionality may appear with the arrival of 'newcomers' into the arena (for example new tax executives) or when some tax rules become the subject of public debate. This study addresses the existence and impact of homogeneity with respect to tax planning in practice, through the NIS lens, and is referred to throughout the findings in Chapters Four to Seven inclusive.

This research provides some insight into a possible *attitude* to tax laws as described by McBarnet (2001a) being held by senior in-house tax personnel within MNCs, and by tax advisors. Do they consciously approach tax planning with a view to specifically availing themselves of opportunities presented under the headings of gaps, ex-files of law or rules? This research seeks to obtain an insight into the attitude of some such individuals to tax laws, and how this attitude impacts on the practice and process of tax planning in their respective organisations.

Another perspective on tax planning entails examining it through the lens of the innovations literature, as advocated by Fallan et al. (1995). They describe research on 'innovativeness' as identifying characteristics which enable the prediction of who will see the advantages and will adopt the innovation such i.e. tax planning.[51] There are different adoption rates of innovations and it varies between adopters in their ability and willingness to adopt.[52] The objective of their study was to 'predict the adoption of tax-planning instruments in business organizations' (p.187). Interestingly, their findings, inter alia, supported the hypotheses that the degree of administrative specialisation positively influences the use of external advisors in the tax-planning process, and that the use of the external networks of tax advisors in the planning process is positively related to the adoption of tax planning instruments. Evidence did not support the hypothesis that the higher the degree of professionalism of the responsible tax planner in the firm, the more use will be made of the external network of tax advisors in the planning process.[53] These three findings were explored further in my study when discussing the relationship in-house tax personnel have with their external advisors. It would be of particular interest to tax authorities to be better able to better predict which companies, based on their profile, are more likely to adopt tax planning instruments, and perhaps invest more generally in sophisticated tax planning activities. The latter may, for example, better position the Revenue Authorities to effectively and efficiently select companies for tax audit, which is clearly an important policy implication.[54]

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[51] In their study 'tax planning' translates into the choice of the optimal tax instruments within legal rules and constraints.

[52] See section 3.4.1.3 for further reference to innovators and adopters (drawing more from the NIS literature) in the context of describing the organisational level of this study's conceptual framework.

[53] 'Administrative specialisation' was captured by age and size of firm, and 'degree of professionalism' was captured by level of tax-relevant education, reading of tax–relevant periodicals and participation in courses on tax planning.

[54] I understand in the UK, that the Revenue Authorities are adopting a risk scoring-based approach to deciding which MNCs they need to look at more closely.

My study provides and interprets the views of in-house tax executives on the existence, or otherwise, of leaders and adopters among MNCs, with respect to the practice and process of tax planning (see Research Question Four and Chapter Seven).

Part of some companies' approach to tax planning, is the lobbying of tax legislators with a view to having specific tax laws introduced or amended to facilitate specific tax planning activities. Karayan and Swenson (2007) refer to companies negotiating at two levels in US. They can lobby Congress and can seek advance rulings from the IRS. They do highlight however that both 'require large outlays of time and money, which may explain why they are typically used only for significant transactions and by large firms' (p.84). Related to this, Roberts and Bobek (2004) posit that 'studies of tax policy and firm tax strategy should explicitly incorporate societal-level interests and recognize that inequalities in resources lead to political inequalities as well' (p.588).

Roberts and Bobek (2004) recognise the state as a 'negotiable contracting party', illustrating the endogenous aspect within tax law making, and thereby demonstrate that companies 'engage in political activities in order to influence the structure of tax accounting laws under which their corporations must operate' (p.567).[55] This study is

[55] They draw on literature on pluralist and Marxist theories. A more fruitful lens through which this aspect will is addressed in this study is NIS and endogeneity of law literature (see sections 2.3 and 3.4).

clearly seeking to understand the nature and impact of such political activity (Research Question Four).[56]

There have been many pieces of academic research conducted primarily by North Americans using the Scholes and Wolfson (1992) framework. Such research has focused on specific aspects of business, such as choice of organisational forms for conducting business and organisational design, taxpayers' choice of savings vehicles, the existence of tax clienteles and making trade-offs between tax and non-tax costs.[57] The empirical research carried out to date on technical tax planning techniques and approaches is highly quantitative. Shackleford and Shevlin (2001), who are advocates of the Scholes and Wolfson (1992) framework, view most of this research as 'documentation' and maintain the move into explanation, understanding and prediction is critical, but slow. Maydew (2001) maintains certain areas of tax in need of research presents an opportunity to engage in qualitative research. The qualitative research being conducted in this study research serves to fill this gap in the literature as it provides a new perspective on tax planning, producing a rich understanding of the practice and process of tax planning in US MNCs.

2.2.5 Tax Risk Management

Any in-house tax department (and ultimately any organisation) is exposed to various risks which need to be managed. Arguably, tax plans should be viewed as part of an organisation's overall RM strategy. Good practice suggests the need to manage such

[56] Consideration of this aspect of tax planning through the lens of the lobbying literature was considered to be outside the scope of this research.
[57] For example, Harris (1993), Klassen, Lang et al. (1993), Maydew (1997).

risks in a structured and formalised way. PWC (2001) found that, in the light of changes in corporate governance (Cadbury and Turnbull),[58] the tax director should develop a tax risk policy to ensure adequate financial controls can be demonstrated. Interestingly, KPMG (2005) notes the Australian Tax Commissioner's public statement referring to tax as 'a corporate governance issue...boards should make conscious decisions about where their companies should position themselves on the tax risk spectrum and ensure the necessary controls are in place to maintain that position' (p.17).[59]

PWC (2001) identified three types of tax risks that need to be managed and controlled namely, operational, planning and compliance. The need for RM in a tax-planning context often arises from the existence of uncertain and inadequate tax legislation (see section 1.3. on the uncertainty aspect of some tax laws). RM strategies often reflect how organisations and, more specifically, how in-house tax professionals deal with such uncertainty. As evidenced by the earlier discussion on the legalistic approach to tax planning (see section 2.2.4) a tax professional's 'attitude' to tax legislation and indeed to law in general is important in this context. Some tax professionals are likely to be risk averse and will therefore steer away from what might be termed 'aggressive' tax plans. Those who are not risk averse, and are happy to work exclusively within the letter of the law, are more likely to engage in more

[58] The Cadbury and Turnbull reports were part of a series of corporate governance guidelines published in the UK in the 1990s.
[59] See Ernst and Young (2006) for results of their survey on tax risk.

'aggressive' tax planning.[60] In terms of understanding what determines the level of tax aggressiveness in a firm, Shackleford and Shevlin (2001) suggest an interesting question: 'Are growth firms, decentralized firms, and firms led by non-financial CEOs less aggressive?' (p.378). Maydew (2001) similarly calls for further research being 'needed to explain why some firms appear to be more aggressive tax planners than other firms' (p.397). While these authors are most likely interested in quantifying aggressiveness, my research obtains a strong sense of the influence of certain individuals (whether it is the CEO, CFO or VP Tax) on a company's position on the tax aggressiveness spectrum.

A tax professional's RM strategy, however, is unlikely to be determined exclusively by one's 'attitude' to the law. With regard to how tax professionals manage tax-planning risks, according to PWC (2001) what the competitors are doing is a significant influence on acceptable risk.[61] From a tax practitioner perspective Hoffman (1961) advocates that a tax practitioner must evaluate the situation carefully before advising a client to take advantage of a loophole in the legislation. He/she needs to give a 'guarded opinion' informing the client of the contingencies involved. His advice can be reached at by, inter alia, seeking advice of fellow practitioners, reviewing tax experts' opinions as published in professional journals, assessing the attitude of the Revenue and taking account of how long the loophole has existed

[60] Tax professionals' 'attitude' to the law and explaining/understanding the extent to which they engage in 'aggressive' tax planning could also be examined through the lens of literature on 'tax aggressiveness', for example, Schisler (1994) and Spilker, Worsham et al. (1999). However, this literature which empirically has tended to focus on tax advisors was not considered appropriate for this study.

[61] Institutional isomorphism – see section 2.3.2.2.

(generally the longer the better). Presumably in-house tax professionals often engage tax advisors as a risk management strategy in the knowledge that the advisors are indeed taking an approach similar to that suggested by Hoffman (1961) when giving tax opinions.

A significant challenge for in-house tax professionals is how to respond to possibly increasingly uncertain tax legislation. This arises due to some finance ministries around the world choosing to deal with creative tax planning by using some 'big power' strategies as referred to earlier (see section 2.2.4). While there is some debate on how effective such strategies are in dealing with 'unintended' tax planning opportunities, they have become a reality for many organisations to deal with. Porter (1999b) reports mixed reaction to the possible introduction of a general anti-avoidance rule (GAAR).[62] Some managers did not see this rule necessitating any change in the workings or strategy of the in-house tax department. A number of these managers considered themselves to be already cautious in their approach to borderline tax schemes. However, others did see themselves becoming more cautious when GAAR was in place. GAAR could be perceived as bringing greater uncertainty into the tax manager's arena, which would not be desirable from their perspective. However, by contrast, McBarnet (2001a) draws a comparison with the accounting function in the context of how uncertain legislation can sometimes be effective from a tax policy perspective. She refers to the cross-eyed javelin thrower in the context of

[62] The US counterpart to GAAR is the business-purpose doctrine (Scholes and Wolfson, 1992: p.26) which requires the proof of a business transaction's validity through practice as well as legal form (see also section 2.2.4). Its primary purpose is to prevent the abuse or misuse of tax laws.

the new principle- based regime of the ASB, where its chairman David Tweedie said 'we're like a cross-eyed javelin thrower competing at the Olympic Games: we may not win but we'll keep the crowd on the edge of its seats' (p.12).

Research conducted by Spilker et al. (1999) produces findings which are 'consistent with recent strategic attempts by the IRS to frustrate tax professionals' ability to tax plan by proposing that tax rule ambiguity be increased in certain areas of the tax law' (p.76). Spilker et al. (1999) conducted experimental research involving tax professionals. Results showed that tax professionals interpret ambiguity aggressively in compliance contexts (considering issues after the relevant transactions have occurred), but relatively conservatively in planning and decision contexts (where advising on structuring transactions to be ultimately reflected ultimately in the tax return with an aim to improve their tax situation).[63]

The above literature on tax RM provides a very limited insight into the management of tax risks in MNCs. This research begins to fill this gap, as it focuses on identifying the main types of risk facing MNCs; understanding the tax risk profile of these companies; understanding what tax RM policies these companies have in place and what are the drivers of these policies are; understanding how a company's tax RM policy impacts on/influences the practice and process of tax planning; what tax RM processes and procedures are in place; and examining how the tax RM policy interacts with an MNC's overall RM policy (Research Question Three).

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[63] For a recent UK study of tax risk and attitudes to avoidance see Freedman, Loomer & Vella (2007).

2.3 Institutional Theory

2.3.1 Introduction

As mentioned in section 2.1, the conceptual framework being utilised in this research for interpretation and analysis of findings draws on three strands of literature: tax planning, NIS and endogeneity of law. This section focuses on NIS and endogeneity of law. Section 2.3.2 describes the core concepts within NIS, drawing primarily on seminal literature primarily, although not exclusively within the sociological/organisational theory domain. Section 2.3.3 sets out an extended NIS perspective which deals primarily with what is by now a recognised shortcoming of earlier NIS-based research i.e. the role of power and politics. Section 2.3.4 reviews the pertinent literature on the endogeneity of law construct representing a theoretical extension of NIS and a form of theoretical triangulation being applied in this research. This is followed in section 2.3.5 by a brief review of literature in the accounting/taxation domain, which has drawn on the theoretical underpinnings of NIS.

NIS provides an appropriate theoretical lens through which the many findings of this research concerning the organisation of tax within MNCs, performance measurement of tax (planning), tax RM, and the relationship between tax and the external environment, can be explained and understood. Importantly, as can be seen from this review, drawing on NIS responds to calls in the accounting literature for examining accounting, — of which tax is an important element, — not as a technical practice, but in the context within which it operates (Hopwood, 1983), recognising the multiple arenas of operation within which it operates and thereby taking account of its social and institutional nature (Hopwood and Miller, 1994). A number of other organisational and sociological perspectives frequently drawn on in accounting research and labelled as 'open system theories' (Llewelyn, 2003) were also considered: contingency theory, resource dependency theory and the sociology of the professions. None of the alternatives were considered to provide a theoretical lens as rich or comprehensive as NIS for explaining and understanding the practice and process of tax planning in MNCs.[64]

2.3.2 New Institutional Sociology (NIS)

Recently, institutional theory has become a rather dominant theoretical perspective applied in the organisational theory domain and in research on accounting in practice. This new institutionalism has, as described by DiMaggio and Powell (1991a), 'a distinctly sociological flavor' (p.11). A significant body of scholarship in the sociology/organisational theory domain has contributed to the theoretical debate on institutional theory (see Powell and DiMaggio (1991) for important contributions by Powell, DiMaggio, Meyer and Rowan, Scott, and Zucker).[65] The move towards NIS, classified as an interpretive perspective (Covaleski, Dirsmith et al., 1996), or a normative cultural perspective that 'stresses the impact of cultural rules, models, and mythologies on organizational structures and practices' (Edelman and Suchman, 1997: p.493), represents a changing emphasis in perspective from efficiency

[64] There is some overlap between NIS and Legitimacy Theory as noted by Deegan (2006). See Deegan (2006) for a detailed discussion on Legitimacy Theory.

[65] A number of contributions to this book were originally published elsewhere (such as the American Journal of Sociology) in the late 1970s/early 1980s. They were republished here (amended in some cases) in this 1991 publication. All references in this thesis are to the 1991 publication.

(concerning technical environments) to legitimacy (concerning institutional environments). NIS reflects the 'dramatic transformation in the way in which social scientists have come to think about human motivation and behavior' (DiMaggio and Powell, 1991a: p.15). A key objective of the contributors to the NIS perspective is to 'develop robust explanations of the ways in which institutions incorporate historical experiences into their rules and organizing logics' (DiMaggio and Powell, 1991a: p.33). According to Covaleski et al. (1986) 'perhaps the single most important contribution of institutional theorists to the study of organizations is their reconceptualization of the environments of organizations' (p.12).

There is no agreed definition of institutions in the literature. Scott (2001) provides a rather comprehensive, 'omnibus conception' of institutions as follows:

> Institutions are social structures...composed of cultural-cognitive, normative, and regulative elements, that together with associated activities and resources, provide stability and meaning to social life. Institutions are transmitted by various types of carriers, including symbolic systems, relational systems, routines, and artifacts...operate at multiple levels of jurisdiction. (p.48)

Institutions therefore, he explains, exhibit resistance to change and tend to be transmitted over time, to be maintained and reproduced (Zucker, 1991). An institutional perspective must also 'encompass associated behavior and material resources...rules norms and meanings arise in interaction, and they are preserved and modified by human behavior' (Scott, 2001: p.49).

A more general definition is provided by Berger and Luckmann (1966). 'Institutionalization occurs whenever there is a reciprocal typification of habitualized actions by types of actors. Put differently, any such typification is an institution' (p.72). Meyer and Rowan (1991) describe institutionalisation as involving 'the process by which social processes, obligations or actualities come to take on a rule like status in social thought and action' (p.42).

DiMaggio and Powell (1991a) explain that NIS concentrates on 'organizational structures and processes that are industry wide, national or international' (p.9). It emphasises how organisations are so homogenous and states that 'taken-for-granted scripts, rules, and classifications are the stuff of which institutions are made' (p.15).[66] Subsequently, however Powell (1991), in attempting to refine and sharpen some earlier arguments with DiMaggio, recognised that 'we need an enhanced understanding of both the sources of heterogeneity in institutional environments and the processes that generate institutional change' (p.183). Powell (1991) outlined key sources of heterogeneity, which explains in part why, despite similarities in the external environment facing MNCs, and many isomorphic forces potentially at play, the practice and process of tax planning among MNCs differ. These include: different resource environments, differences in industry structure and how organisations relate to the state, partial or fragmented governance, professional and occupational

[66] According to DiMaggio and Powell (1991a: p.9) NIS in organisational analysis 'takes as a starting point the striking homogeneity of practices and arrangements found in the labor market, in schools, states, and corporations'.

diversity. Importantly, as recognised by Powell (1991), 'not all forms of social change can be explained from an institutional point of view' (p.200).

Dillard, Rigsby and Goodman (2004), advocates of the NIS perspective state that institutional theory is:

> Primarily concerned with an organization's interaction with the institutional environment, the effects of social expectations on the organization, and the incorporation of these expectations as reflected in organizational practices and characteristics. (p.508)

They believe it is 'a way of thinking about formal organization structures and the nature of the historically grounded social processes through which these structures develop' (p.508).[67] According to Hussain and Hoque (2002), NIS 'adopts a broader, multi-dimensional approach for focusing on issues of external (macro) and internal (micro) organizational contexts' (p.164). They also posit that this perspective 'has contributed significantly to the understanding of the relationship between organizational structures and the wider social environment in which organizations are situated' (p.164).

Hopwood (1983), whilst not using the term NIS, referred to organisational influences on accounting (which incorporates taxation) being 'seen to be specific manifestations of social influences, pressures and tensions' (p.301). He referred to the role of the state, the media and professional institutions of the accounting craft (or taxation craft in this study) 'in establishing a view of both the prevailing technical state of the

[67] See sections 3. 4 for more in-depth references to Dillard et al. (2004).

accounting art and those managerial practices which were regarded as legitimate and in order' (p.301).

While some NIS-based research focuses on how institutions undergo change over time, an equally valid pursuit, which is being pursued in this study, is to establish what 'institutions' are in action in the tax planning world today, and to gain the perspective of arguably powerful actors in the tax arena, (in terms of creating, and maintaining and changing institutions), as to how these institutions are then maintained. Insight is gained also on how institutions in taxation change over time, as many of the interviewees have been part of the tax world for many years. Importantly for this study, Powell's (1991) call for an 'expanded institutionalism requires that the focus of empirical research should not be confined to the public and nonprofit sectors, and that more attention be directed to such core sectors of the economy as manufacturing and finance' (p.189). Equally important, he refers to accounting practices (which clearly incorporates taxation) as strongly shaping institutional expectations and pressures. Also he states, 'as firms grow in size and become involved in industry activities as well as dense networks of exchange, the institutionalized expectations of other firms, consumers, and the government exert greater influence on their behavior' (p.188). Powell's arguments position NIS with significant explanatory power for understanding the practice and process of tax planning within large MNCs in SV.

Three common themes, namely legitimacy, isomorphism and decoupling, permeate throughout NIS-based research, and they provide appropriate theoretical constructs through which to examine the institutions of tax planning. The literature pertaining to these three themes is reviewed below. Following this, the different levels of analysis at which NIS-based research has been carried out are addressed.

2.3.2.1 Legitimacy

The first theme concerns *legitimacy-seeking behaviour* which refers to what is considered 'appropriate behavior' by constituents in the environment with which organisations must interact (for example shareholders, general public, professional organisations and regulators). *Legitimacy* is a core concept within NIS. This concept is rooted in the idea that organisations need to be socially acceptable and credible in order to survive in their social environment (Scott, 2001). Suchman (1995) defines *legitimacy* as 'a generalized perception or assumption that the actions of an entity are desirable, proper, or appropriate within some socially constructed system of norms, values, beliefs, and definitions' (p.574).

According to Scott (2001), legitimacy is 'a symbolic value to be displayed in a manner such that it is visible to outsiders' (p.59). The use of language is very important here as terms such as 'symbol', 'value' and 'display' arguably suggest how an organisation (with respect to tax in this study) or indeed an individual (an in-house tax executive in this case) is perceived by various constituents within its/his/her extant environment. This is, (a) very important for survival, and, (b) does not necessarily reflect the reality. Carruthers (1995) refers to the effective survival strategy of 'achieving legitimacy in the eyes of the world, state, powerful professions, or society at large' (p.317). Managing how an organisation or an individual is perceived with respect to tax, by the complex set of external constituents present in the tax arena, (tax regulators; professional representative organisations; industry representative groups; peer organisations and individuals; external auditors: the general public)[68], with many and sometimes conflicting views or 'competing sovereigns' (Scott, 2001: p.60) on what constitutes legitimate behaviour, is truly a challenging task. How this is accomplished, along with its importance and implications for practice and policy, merits investigation.

Dillard et al. (2004) refer to the economic and political context of market capitalism, which delivers the primary legitimising characteristic of economic efficiency. Importantly, Scott (2001) recognised the restricted conception posited by NIS theorists in the earlier days, himself included (Scott and Meyer, 1991), which viewed institutional processes as opposing efficiency concerns, whereas subsequent research sees institutional processes as 'shaping and interacting with interest-based efforts. Institutional structures do not frustrate but frame rational decision making' (p.135). Hopper and Major (2007) found that 'social and economic pressures were inseparable' (p.61). Likewise, Powell (1991) maintained 'institutional and competitive processes are not necessarily oppositional' (p.183). Covaleski et al. (1996) describe the general theme of the institutional perspective as thus: 'an organization's survival requires it to conform to social norms of acceptable behavior

[68] Scott (2001) specifically refers to how professional and trade associations and agents of the state are often critical for organisations in this context, all of which are a part of the external tax environment.

as much as to achieve levels of production efficiency'. Hopper and Major (2007) summarised this issue well:

> Leading NIS researchers now recognize that institutional and economic pressures are not mutually exclusive or oppositional, can confront organizations simultaneously, and prevail on both public and private organizations. (p.63).

This progression is extremely important in the context of this study, which deals with MNCs, for whom arguably economic efficiency, however measured, is central to their very survival. Covaleski et al. (1996) also refer to formal organisational structures and how structures that adhere to the norms and behaviour expectations in the extant environment effectively prevents the organisation from being questioned about its conduct. The need to establish procedural legitimacy may be greater among organisations whose processes have a high degree of arbitrariness, which makes them more vulnerable to attacks on their work arrangements and procedures (Scott, 1987). Interpretation of tax laws sometimes require judgement, which brings with it some degree of arbitrariness, and ultimately may result in organisations being under the scrutiny of the tax legislators, who may well be keen to observe, at minimum, rational procedures that are in place in support of whatever judgement is applied. The procedures themselves, providing a form of scientific rationality, are seen as primary legitimating characteristics which establish appropriateness and rationality:

> Organizations are driven to incorporate the practices and procedures defined by prevailing rationalized concepts of organizational work and institutionalized in society. Organizations that do so increase their legitimacy and their survival prospects, independent of the immediate efficacy of the acquired practices and procedures. (Meyer and Rowan, 1991: p.41)

Notwithstanding the recognition of economic efficiency within the realm of NIS, 'the point is not to discern whether institutions are efficient, but to develop robust explanations of the ways in which institutions incorporate historical experiences into their rules and organizing logics' (DiMaggio and Powell, 1991a: p.33).

2.3.2.2 Institutional isomorphism

Inextricably linked with legitimacy is the second theme within the NIS literature, namely *institutional isomorphism,* which constitutes the adaptation of institutional practice by an organisation, which ultimately 'promotes the success and survival of organizations' (Meyer and Rowan, 1991: p.49).[69] Covaleski and Dirsmith (1988) describe the effort within isomorphism as being 'directed at building both an agreed-upon knowledge base and rational-appearing tools of practice' (p.563). DiMaggio and Powell (1991b) contend that institutional isomorphism 'is a useful tool for understanding the politics and ceremony that pervade much modern organizational life' (p.66). They identify three classifications of isomorphism: coercive, mimetic and normative. Scott's (2001) typology refers instead to three 'pillars of institutions' which provide bases of legitimacy: regulative systems, normative systems and cultural-cognitive systems. Scott's three pillars clearly equate with DiMaggio and Powell's classifications of isomorphism. I will hereafter primarily refer to DiMaggio and Powell's classification, on the understanding that they encapsulate Scott's ideas in this context, as was recognised by Scott (2001) himself. There is also some degree of overlap with the three processes referred to by Meyer and Rowan (1991) that generate rationalised myths of organisational structure: the elaboration of complex

[69] DiMaggio and Powell (1991b) also recognise competitive isomorphism but contend it does not present a fully adequate picture of the modern world of organisations', so they focus on institutional isomorphism as does this study.

relational networks, the degree of collective organisation of the environment and leadership efforts of local organisations.

While distinguishing between different types of isomorphism may be useful, such a distinction may not always be easily made and indeed these three forces of isomorphism are not necessarily mutually exclusive. For example, Edelman and Suchman (1997) state that 'the literature increasingly suggests that multiple isomorphic pressures may operate together in any particular historical instance' (p.497).[70] Each classification does offer potential in terms of understanding the external forces at play influencing the legitimising behaviour of some MNCs with respect to tax planning. A reasonable working assumption is that tax planning needs to be legal, and therefore it should be expected that a prominent source of *coercive isomorphism* comes from tax legislation, which contains many rules, and sanctions. Companies that engage in legal tax planning only gain legitimacy through their tax plans being 'legally sanctioned' (Scott , 2001: p.52). However, as noted earlier, the meaning and application of tax rules is not always easy, clear or certain (see sections 1.3 and 2.2.4). Here, an NIS perspective makes for an informative lens through which to understand how executives engaged in tax planning manage ambiguity in tax laws.[71] Due to the ambiguity of some tax laws, their existence alone does not constitute per se a source of organisational isomorphism and one may have to 'explore the complex ways in which organizations may mediate the impact of legal

[70] Further analysis of the three classifications here however will focus on how they differ from each another. Scott (2001) emphasised also that his typology was not intended to rule out 'inter-pillar communication'.

[71] See Hasseldine (2005) for a discussion of behavioural studies of tax practice, some of which address judgement and decision making in situations where the tax treatment is ambiguous.

mandates and may construct the meaning of legal compliance' (Suchman and Edelman, 1996: p.941). Suchman and Edelman posit that institutional theory 'obscures the extent to which law is, in reality, obscure, fragmented and highly ambiguous' (p.929). As noted by Scott (2001), 'many laws are sufficiently controversial or ambiguous that they do not provide clear prescriptions for conduct' (p.54). See section 2.3.4 on endogeneity of law which addresses the different responses of the regulated to 'uncertain' tax rules, which suggests the government (through its tax laws in this context) may not be in such a dominant position as NIS theorists might have placed it originally. The latter clearly questions Fligstein's (1991) conclusion that 'the state can actually set the rules of the game for any given organizational field...It can, therefore alter the environment more profoundly and systematically than other organizations' (p.314).

Normative isomorphism however, is concerned with specifying how things should be done and 'stems primarily from professionalization' (DiMaggio and Powell, 1991b: p.70). It is thereby concerned with pursuing legitimate means to, for example, minimise taxes. They refer to the important mechanisms of 'filtering of personnel',[72] 'occupational socialization',[73] and relatedly in the same context identify two important sources of normative isomorphism relating to professionalisation, which apply particularly apply in the tax domain:

One is the resting of formal education and of legitimation in a cognitive base

[72] Occurs through hiring individuals from firms in the same industry, through the recruitment of fast-track staff from a narrow range of training institutions etc.
[73] Takes place in trade association workshops, employer-professional-school networks, trade magazines and so forth.

> produced by university specialists; the second is the growth and elaboration of professional networks that span organizations and across which new models diffuse rapidly. (p.71)

This classification is concerned with professional ethics and unveils for example the 'rules specifying how the game is to be played, conceptions of fair business practices...how the specified actors are supposed to behave' (Scott, 2001: p.55). Again there is an interesting use of language here in the terms 'game', 'actors' and 'fair business practices'. The idea of 'best practice' permeates through the professions generally. In a tax context, this represents (at times) the focus moving away somewhat from the importance of the strict interpretation of tax rules to working within the spirit of the law (see section 2.2.4 for further discussion on this). Normative isomorphism assumes the provision of guidance on moral governance to achieve the legitimacy objective. Providers of such moral governance in the tax domain include professional tax representative groups and influential peers in the business (i.e. tax executives working in other MNCs). Normative forces of isomorphism, while clearly at times clearly constraining certain approaches to tax planning or means of dealing with Revenue Authorities, they may also, as noted by Scott (2001) 'empower and enable social action', another interesting dimension in the tax context.

The *mimetic* sources of isomorphism differ from the other two as they revolve around 'the shared conceptions that constitute the nature of social reality and the frames through which meaning is made' (Scott, 2001: p.57), and are less tangible perhaps than the other two. Carruthers (1995) posits that '[O]rganizational fads and fashion seem likely to spread through mimetic isomorphism'. Mimetic isomorphism recognises the influence of external cultural frameworks and is particularly present in uncertain environments (such as uncertainty in interpretation of tax laws). 'It is a response to uncertainty' (DiMaggio and Powell, 1991b: p.69). This modelling 'may be diffused unintentionally, indirectly through employee transfer turnover, or explicitly by organizations such as consulting firms or industry trade associations' (p.69). My study unveils the various sources of mimetic isomorphism that exist in relation to the practice and process of tax planning (for example networking and tax professional institutes etc.), resulting in a very particular 'social reality' (Berger and Luckmann, 1966) for tax executives (see Chapter Seven).

Of potential significance in the context of interpreting ambiguous tax laws, Carruthers (1995) states: 'There is reassurance if not actual safety in numbers, and in the absence of a compelling reason to strike out on their own, organizations do what others are doing' (p.317). The latter may lead to tax executives engaging in the practice and process of tax planning in a similar manner making them a homogenous group (DiMaggio and Powell, 1991a). However, as my study demonstrates, the practice and process of tax planning is not always the same in all MNCs in SV. This study gains an understanding of why certain tax plans, processes and structures are copied and adopted by some organisations and not by others. Specifically, in relation to new ideas and tax plans the concept of 'diffusion of innovation' comes into play and the perhaps the concept 'that organizations imitate others whom they perceive to be successful or prestigious' (Scott, 2001: p.162).[74] Equally, is it the case that 'diffusion

[74] See section 3.4.1.3 for more on the existence of leaders, adopters and late adopters.

occurs only if new ideas are compellingly presented as more appropriate than existing practices' (Greenwood, Suddaby and Hinings, 2002: p.60). Another challenging role for the in-house tax executive is as 'mediator', marrying the 'social reality' of the corporation with the 'social reality' of the wider tax world within which and with which he/she engages constantly at some level.

2.3.2.3 Decoupling

The third theme within the NIS literature is *decoupling* 'which is treated as a hallmark of institutional conformity' (Scott, 2001: p.173). It refers to the situation in which the formal organisational structure or practice is separate and distinct from actual organisational practice i.e. the practice is not integrated into the organisation's managerial and operational processes. The decoupling process 'relies on both societal and organizational actors functioning in an atmosphere of confidence and good faith and not taking the institutionalized structures too seriously' (Covaleski and Dirsmith, 1988: p.563).

According to Meyer and Rowan (1991), such formal structures constitute 'powerful myths' which are often in conflict with efficiency criteria. There may be therefore a formal and an informal structure with 'the former reflecting officially sanctioned offices and ways of conducting business, the latter, actual patterns of behavior and work routines. An uneasy tension exists between these structures' (Scott, 2001: p.153). Scott goes on to point out that such formal structures are 'ceremonial' and while they 'signal conformity', some organisations buffer internal units, allowing them to operate independently of these pressures. As posited by Meyer and Rowan (1991):

> To maintain ceremonial conformity, organizations that reflect institutional rules tend to buffer their formal structures from the uncertainties of technical activities by becoming loosely coupled building gaps between their formal structures and actual work activities. (p.41)

Importantly in a tax context, Edelman and Suchman (1997) noted that 'regardless of the underlying motivation, the decoupling of ceremony from substance arguably undercuts and marginalizes the role of law in organizational life' (p.496). Within an industry (such as the information technology sector which is the focus of this study), this concept of decoupling explains why MNCs may be similar in terms of formal practices and procedures around aspects of tax planning, but display diversity around the actual practice (see section 4.6.2 for example in relation to tax strategy statements).

As noted by Covaleski et al. (1996), Zucker (1991) argued that 'the rationalization in formal control systems is an important part of a network of political and power relations which are built into the fabric of social life, a process of transforming the moral into the merely factual' (p.11). There is some obvious overlap between the theoretical constructs of decoupling and legitimacy-seeking behaviour. There has been without doubt a significant increase in tax compliance and audit procedures, as evidenced by the findings of this research. The interesting question to be addressed, however, is whether the tax executives perceive such procedures and processes to be an integral and formative part of tax planning in practice. Are these formal structures and processes, which admittedly might secure organisational legitimacy, reflecting the practical activity of the organisation? Meyer and Rowan (1991) posit that they may not, as the practical demands for efficiency may conflict with the need to be seen to conform to society's expectations. How, for example, has this increased compliance-type environment really impacted on tax executives' (and companies') attitude to, and appetite for, the practice of tax planning? Are the additional compliance procedures more about maintaining appearances of legitimacy? According to Scott (2001), 'it is a truism of modern organization studies that organizations are highly differentiated, loosely coupled systems in part because they must relate to many and different environments' (p.157). Importantly for this study, Meyer and Rowan (1991) identify the professions (which include tax professionals) as an example whereby elements of their formal structure 'are highly institutionalised and function as myths' (p.44).[75] Such professionalisation 'binds both supervisors and subordinates to act in good faith' (p.58).

While Carruthers (1995) cautions against over-emphasising the degree of decoupling, his description is rich, especially when considered in a tax-planning context:

> Formal plans, decision-trees, econometric forecasts, specification of contingencies and alternatives, quantitative estimates, and the ample use of accounting information all help to enhance the *post hoc* legitimacy of a decision. New institutionalists claim that these rationalized features usually do not determine how the decision was made, for they concern how the decision gets presented to the outside world after the fact. (p.322)

[75] Meyer and Rowan continue: 'these are occupations controlled not only by direct inspection of work outcomes but also by social rules of licensing, certifying, and schooling' (p.44).

He does go on to warn that some audiences (the IRS perhaps) are mindful of decoupling, 'especially if it becomes too extreme' (p.323).

The next section addresses the different 'levels of analysis' at which NIS-based research has been carried out, focusing in particular on the importance of identifying and understanding the potential impact which the members of the 'organisational field' can have on the practice and process of tax planning.

2.3.2.4 Levels of Analysis

NIS-based research has been carried out at different levels of analysis. While there is not a consensus on exactly how many levels of analysis exists, the three levels of social systems put forward by Dillard et al. (2004) are capable of encapsulating the many and varied actors involved in the tax arena. An understanding of the level, means and extent of interactions between actors at all levels provides an insightful perspective on, inter alia, the construction of the 'social reality' within which these actors operate. The three levels of social systems of (i) economic and political, (ii) organizational field, and (iii) organizational level, map well onto other typologies used in NIS.[76] Dillard et al.'s framework facilitates an understanding of both the context and processes associated with creating, adopting and discarding institutional practices.[77] In my study it is a particularly useful tool for presenting a picture of the various actors involved in the tax arena, and for explaining and understanding the

[76] Scott (2001) for example identifies six levels: world system, society, organisational field, organisational populations, organisation, and organisational subsystem.
[77] However, as noted by Scott (2001: p.126) 'to attend too rigidly to the distinction between levels of analysis is to ignore the ways in which social phenomena operate as nested, interdependent systems, one level affecting the others'.

political nature of institutional change in the tax world. It helps understand the complex external environment within which in-house tax executives operate. [78] Establishing who the constituents are at each level in itself (an objective within Research Question Four) is in itself an important first step and as DiMaggio and Powell (1991b) pointed out in relation to the structure of the organisational field, 'it must be defined on the basis of empirical investigation' (p.65).[79] While these levels of analysis will be revisited in detail in section 3.4, the most important and influential level in the context of understanding the tax arena is the organisational field. This merits some further explanation at this stage as 'the concept of organizational field is central to institutional theory' (Greenwood, Suddaby et al., 2002). DiMaggio and Powell (1991b) who posit that the virtue of the organisational field unit of analysis lies in its directing attention 'to the totality of relevant actors' (p.65), define the organizational field as:

> those organizations that, in the aggregate, constitute a recognized area of institutional life: key suppliers, resource and product consumers, regulatory agencies, and other organizations that produce similar services or products. (p.64)

Scott's (2001: p.84) description of the field helps understand how actors contained therein could indeed create their own 'social reality' over time:

> The notion of field connotes the existence of a community of organizations that partakes of a common meaning system and whose participants interact more frequently and fatefully with one another than with actors outside of the

[78] As mentioned earlier the perspective being gained on the process of institutional change in this study is being obtained through obtaining some historical perspectives on change by talking to some individuals in the 'game' for a long time. It does not focus on one particular change per se, although some interviewees did speak specifically of the recent Homeland Investment Act (part of the American Jobs Creation Act 2004) and how and why that came to being.

[79] Scott and Meyer's (1991) definition of 'societal sector' is similar to DiMaggio and Powell's definition of 'organisational field'.

field.'[80]

DiMaggio and Powell (1991b) refer to four parts of the process of institutional definition, which has significance in the tax domain:

> An increase in the extent of interactions among organizations in the field; the emergence of sharply defined interorganisational structures of domination and patterns of coalition; an increase in the information load with which organizations in a field must contend; and the development of a mutual awareness among participants in a set of organizations that they are involved in a common enterprise. (p.65)

Upon examination of the above passage, Barley and Tolbert (1997) posited that 'in their early work, institutionalists explicitly postulated that institutions exhibit an inherent duality: they both arise from and constrain social action' (p.95).

This provides a rich description of how a group of tax experts, working in MNCs of various sizes, dealing with complex ever-changing tax rules on a global basis, working in the same industry, in the same geographical area, dealing with the same regulators, meeting each other through many fora, are ideally positioned to 'construct' a tax community. The latter has important implications for the practice and process of tax planning in MNCs.

NIS theorists identify types of institutional influences that potentially have strong effects at all levels of analysis which that are particularly pertinent in the tax arena, namely the nation-state, the professions, international organisations and associations, and cultural frameworks (Scott, 2001; DiMaggio and Powell, 1991b). The latter maps

[80] This quotation is reproduced here from one of Scott's earlier publications (1994).

well onto the recursivity aspect of Dillard et al.'s (2004) framework, which is also an important aspect of my study's conceptual framework (see section 3.4) Notably, DiMaggio and Powell (1991b) see the state and the professions as having become 'the great rationalizers of the second half of the twentieth century' (p.64), and are therefore held responsible for bureaucratisation and other forms of homogenisation emerging. The importance of recognising the existence and impact of the organisational field is of particular relevance in the sometimes uncertain terrain of tax laws and the interpretation thereof. DiMaggio and Powell (1991b) state:

> Highly structured organizational fields provide a context in which individual efforts to deal rationally with uncertainty and constraint often lead, in the aggregate, to homogeneity in structures, culture and output. (p.64)

While the latter essentially reflects how institutional isomorphism leads at times to homogeneity, it does not explain institutional change or entrepreneurship. It is important therefore to note the role of individual agency also. Scott (2001) emphasises the varied and complex interrelations that exist between professional and political actors, an aspect which is being explored in this study. With particular relevance to the tax domain, he goes on to state:

> In some instances, the professional associations and practitioners have been so effective in staking out and defending their jurisdictional claims against competitors that they have been invited to assist the state in exercising control over all providers of designated services. (p.129)

The latter is expanded on further in the next section.

2.3.3 NIS Extended

This section addresses some recommended extensions of NIS being addressed and employed in this study. Section 2.3.2.1 described, inter alia, how institutionalists have moved on to accept and incorporate the co-existence of legitimacy and efficiency concerns in their research. This section addresses an extremely important and relevant extension (in the context of the tax arena) of NIS which considers the role of certain actors and organisations, the 'power' they have in terms of maintaining and creating institutions in the tax planning domain, the source of such power and the ways in which they use this power, along with the associated implications. As noted by Covaleski et al. (2007a) 'institutionalization as a process may be profoundly political and reflects the relative power of organized interests' (p.8).

There have been a number of calls for addressing power within the NIS perspective. Perrow (1985) was concerned that power and group interest has lost out to 'cultural myths and symbols' within institutional theory (p.154). Covaleski and Dirsmith (1988) refer to the institutionalist perspective's assumption of passivity and lacking 'consideration of the active agency by which various social actors may construct, change, and enforce' societal expectations and being 'inattentive to power and self-interest in terms of both societal and organizational actors' (pp.562-3). Dillard et al. (2004) refer to the 'neglect of power, special interest and the political nature of organizations' (p.522) as a limitation of prior institutional theory research and importantly posit '[a] significant element of institutionalization is an ongoing product of the political efforts of actors to accomplish their ends' (p.510). Carruthers (1995) also refers to this call among institutionalists for 'greater attention to issues of politics, power and conflict...and to focus on myth and ceremony is to overlook power and control' (p.324-5). Hopper and Major (2007) refer to the importance of 'power struggles and conflicts' in their study of why a Portuguese telecommunications company adopted activity based costing. Examining the extent to which in-house tax executives are powerful both within and outside of their organization is addressed in this research. Such actors may be able (individually or collectively such as via a professional institute) to use their power to impact on the social world by getting the rules of the game changed, impacting on accepted practice and resource distribution, thereby creating and maintaining institutions.

Scott (2001) notes this important progression by institutional theorists towards giving 'more attention to the ways in which both individuals and organizations innovate, act strategically, and contribute to institutional change' (p.75). He posits that there has been an increase in attention given to 'the play of power and the role of agency in institutional analysis' (Scott, 2001: p.193). Powell (1991) recognises 'the exercise of power' as an avenue of institutional reproduction: 'Elites may be both the architects and products of the rules and expectations they have helped devise' (p.191). Such elites tend to be 'knowledge experts' (tax) and/or skilful negotiators. Covaleski et al.'s (2005) study posited the reinforcement of the notion that, after negotiations, 'the form the resulting institution takes depends on the relative power of the actors who support, oppose, or otherwise strive to influence it.'[81]

[81] Covaleski and Dirsmith (1988), Barley and Tolbert (1997), Covaleski, Dirsmith and Weiss (2007a), Covaleski et al. (2007b), DiMaggio and Powell (1991a), Dillard et al. (2004) and Covaleski et al. (2005), go some way to address 'power' as does this research.

Moll, Burns and Major (2006) refer to calls for NIS to integrate more with 'micro' explanations and acknowledge 'the interactive nature of institutional processes, incorporating the intra-organisational processes and the interests and generative capacity of actors into the perspective' (p.188). My study addresses both internal and external sources of power that impact on the process and practice of tax planning and assesses the extent to which in-house tax personnel exercise power both within and outside of their organisations. As noted by Wickramasinghe (2006), 'given the centrality of power in any social relation, power is a central concept in any social and organization theory' (p.354). Just as he posits that power is fundamental to accounting, it is fundamental to tax management. While this study does not employ any framework of power as such, it is does recognise it as a factor to be explained and understood in terms of its impact on the practice and process of tax planning. It is important therefore briefly to briefly address its meaning. Wickramasinghe (2006) refers to a number of sources on the definition of power, which reflect the idea that power is 'one's ability to carry out his/her own will in a social relationship, despite resistance' (p.340).

Of relevance in a tax context, he continues 'some people exercise power in uncertain situations through their distinctive knowledge, skills and expertise' (p.341). Importantly, 'Power creates, and relates to, politics and resistance within and without organizations. When power mobilizes through relations, and between people, politics is inevitable.' (p.341) As noted by Scott (2001), some theorists in the institutional theory domain have begun to widen their theoretical frames, which incorporate multilevels and recursive models. In the context of such a highly regulated domain as tax, extending NIS in a way which embraces the work of legal scholars (Edelman and Suchman, 1997) brings some valuable additional insights into the ways in which US MNCs relate to institutional environments with respect to tax. Extending NIS in this way responds to any shortfalls considered to exist within the NIS framework (as described thus far) by legal scholars:

> Who complain that institutionalists too often embrace a legal formalism stressing the external, objective, rational nature of law. Rather, as Suchman and Edelman (1996); see also Edelman and Suchman 1997) propose, laws and regulations are socially interpreted and find their force and meaning in interactions between regulators and the regulated. (Scott, 2001: p.169).

This extension recognises the 'endogenous process' of tax law-making which is further addressed below. This particular theoretical perspective is insightful in terms of understanding the nature and purpose of the relationship between MNCs (via their senior tax executives and representative groups) and their external environment, encapsulating the notion of power and powerful actors/organisations. Its contribution therefore is primarily in the context of addressing Research Question Four (section 3.2 and Chapter Seven).

2.3.4 Endogeneity of Law[82]

This study explores the 'endogenous process' that takes place in bringing certain tax laws and the application thereof to fruition. This ultimately results, quite often, in both sides being satisfied i.e. the regulated and the regulator. It does not therefore

[82] See Hopper and Major (2007) for an alternative extension of NIS, incorporating economic, labour process and actor network theories.

take the traditionally-taken view of NIS theorists who interpret 'governmental regulations as an exogenous force shaping the behavior of those regulated' (Dirsmith, Huddart and Jagolinzer, (2007). The endogeneity of law perspective pays attention to active agency and the play of power and politics in the context of understanding the social construction of meaning of tax laws.

According to Edelman, Uggen and Erlanger (1999), law is rendered 'endogenous' whereby 'organizations are both responding to and constructing the law that regulates them...the content and meaning of law is determined within the social field that it is designed to regulate.' (p.407) They examined the construction of the meaning of compliance with European employment opportunity law through consideration of the interactions between organisations, the professions and the courts and they posit that their arguments in this context should be applicable to other areas (such as tax law).[83] [84] Such interactions, according to Edelman et al. (1999), result in the development of a particular 'ideology of rationality over time.'[85] This endogeneity of law perspective therefore challenges particularly the effectiveness of the state/government as a source of coercive isomorphism. (See section 2.3.2.2 on isomorphism). This may arise largely due to the sometimes ambiguous and uncertain nature of the meaning of tax laws. Edelman et al. (1999) thereby extend the NIS perspective by seeking to 'specify how the diffusion of institutional structures affects their market rationality' (p.408).

[83] See section 8.4 for further study recommendation in the tax arena along the lines of Edelman et al.'s study.
[84] Similarly, in section 2.2.4, I referred to McBarnet (2001b) regarding creative compliance (with tax laws) as a general law and related her discussion to the accounting discipline.
[85] They reviewed data from the professional personnel literature, the courts and a national sample of organisations.

There is a strong connection here with some of the writings by McBarnet and Whelan, as reviewed in section 2.2.4. In particular, when McBarnet and Whelan (1992) refer to the role of the regulated in actively resisting law as having explanatory power in terms of understanding the ineffectiveness of law (on-the-books). Such resistance amounts in part to the playing out of the game, and the social construction of the meaning of law, within this endogeneity of law framework.[86]

Suchman and Edelman (1996) posit that the interplay between organisations and their legal environment (tax legislators/legislation in this case) results in a relationship that is a 'highly endogenous and reciprocal one' (p.938), which suggests that corporate interests play a role in tax policy development.[87] They call on institutionalists to 'consider how organizations *mediate*, not just respond to, law' (p.933) and emphasise the political process that precedes law-making.[88]

As taxation is an area of law, regulating organisations, it is therefore

> especially open to social construction because corporate lobby is usually successful in softening regulation that infringes on corporate interests, thus producing broad, vague mandates. (Edelman et al., 1999, p.407)

The focus of this study is not to describe the 'endogenous process' associated with any one piece of specific tax legislation, but rather to examine the existence at all of this process generally within the tax domain, and to obtain the tax executives' perspective on the workings of the process and the extent to which they believe they

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[86] See section 3.4.1 also which draws attention to a further conceptual link with Dillard et al.'s 'dynamics of interaction' typology within the NIS literature.
[87] See Roberts and Bobek (2004).
[88] See Radaelli (2005) for a discussion of taxation research as political science research.

shape tax policy through such a process.[89] While the latter would be expected to include lobbying, this study enhances our understanding of such lobbying activities in practice and establishes whether the endogenous process extends beyond lobbying.[90] Such findings would help establish whether these MNCs and their tax executives are 'active players' or 'passive pawns' (Scott, 2001) when it comes to dealing with proposed and actual tax changes. Their strategic responses could be categorised as one of Oliver's (1991) five strategic behaviours: acquiescence, compromise, avoidance, defiance and manipulation. Evidence of all forms of response was found in this study in relation to existing and new tax laws (see Chapter Seven).

Manipulation is arguably the 'most active response to such regulatory pressures because it is intended to actively transform or exert power over the content of the regulation of the governmental agencies that interpret and enforce them' (Covaleski et al., 2005: p.125). Suchman and Edelman (1996) assert that the reciprocal relationship between law and organisations appears at intraorganisational, organisational and environment levels. In relation to the first of these, they make an important point in the context of addressing why and how tax becomes perceived to be 'important', high profile or embedded within an organisation:

> Political considerations will move certain camps within the organization to portray a particular legal threat as uniquely fearsome or to portray a particular solution as uniquely effective. If the organization acts on these alarms, and if other organizations imitate its actions, the standards for compliance in the organizational field are likely to strengthen, and the law may matter more than the rules on paper would suggest. (p.939)

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[89] See Kelly (2003) for an illustration of the endogenous process in the context of a specific tax law related to dependent care expense accounts and employer-sponsored child-care centres.
[90] See Chapter Seven for important findings on this.

Organisations tend to define the law through their practices regarding compliance, usually resulting in 'prevailing industry practices' (p.939). And finally, at the environmental level, they assert that the speed at which standards of practice emerge and stabilise 'depends quite intimately on the structure of communication channels in the interorganizational environment' (p.940). They suggest accordingly that the presence of professional networks and trade publications in a sector leads to experiencing the law as more concrete and binding compared to sectors where such features do not exist.

In their endeavour to categorise literature on law and organisations, and highlighting how they both intertwine, Edelman and Suchman (1997) refer to the 'growing literature that discusses the endogeneity between law and organisations' (p.479). This development, they posit is still at a very early stage and needs to be developed conceptually, but is explained somewhat by the pervasive presence of the legal environment (which would clearly include tax laws) within which organisations operate today.[91] Suchman and Edelman (1996) refer to the 'New Institutionalism' organisational theories as providing an appropriate backdrop for synthesising an integration of the sociology of law and sociology of organisations. Of particular relevance in a tax context, where the regulatory environment is often ambiguous, Edelman and Suchman (1997) refer to law developing meaning 'through its

[91] See also Suchman and Edelman (1996) where they promote an active dialogue between the worlds of legal and organisational scholarship and posit that about NIS which is of value for students of law and organisations. Essentially, they refer to the central themes within NIS, drawing on many of the NIS scholars referred to in the literature review on NIS above. References to the work of Suchman and Edelman in this section are restricted to the endogeneity of law construct.

interpretation by organized professions, and it develops substance through its application by organizational compliance officers' (p.480). They argue 'that organizations construct and configure legal regimes even as they respond to them' (p.484), and that it is rare for regulations to 'emerge independently of the organizational actors whom they ostensibly govern' (ibid, p.488).

The notions of 'complex networks of power' and organisations working together as members of trade associations and industry working groups (for example the various taxation industry groupings found in this study to exist in SV and beyond) are central to the endogeneity of law perspective. Equally important is the notion that organisations sometimes actively seek the implementation of certain types of regulations to obtain certain advantages. My study provides insight into the 'game-playing' or 'politicking' that takes place in relation to new tax laws being introduced which arguably are more advantageous for a certain few (with the 'power' to obtain what they seek) rather than for the greater good. Edelman and Suchman (1997) rather aptly state that 'a great deal of lawmaking seems to respond primarily to the parochial interests of targeted firms, industries, and sectors' (p.489). The endogenous relationship continues beyond regulation into compliance, an aspect which is very relevant in the tax domain where tax audits take place, the purpose of which quite often incorporates assessing an organisation's processes and procedures. The tax legislature often fails, however, to provide significant guidance on compliance procedures. The organisations themselves therefore also have an influence here in that they are often the creators of processes and procedures which are accepted by the regulators and ultimately become the only acceptable processes. Some aspects of new taw laws therefore may be implemented in practice not through 'hard enforcement' but the favoured 'informal enforcement methods such as education, persuasion, negotiation and publicity' (p.490). There is a wealth of expertise on tax matters on both the regulator and regulatee sides, but an interesting aspect to examine is the extent to which the regulated regulators depend on or use the expertise of the regulated to help them create/amend tax laws. In so doing, this demonstrates how influential certain taxpaying organisations are on the tax regulatory process. This essentially addresses the issue of who is more powerful in terms of tax knowledge production. The wider implications of where such power resides should be addressed.

Edelman et al. (1999) suggest that while organisations might seek to respond rationally to law, 'The definition of rationality is constructed and evolves at the environmental level, driven by institutionalized stories about the value of particular organizational structures and actions' (p.411). In responding to new tax legislation for example, I have found evidence that tax executives look to other tax executives (isomorphism) outside of their organisations (on an individual basis or via professional institutes), and to their advisors to help them to respond in what becomes an accepted form of rationality.

Inextricably linked with NIS, Edelman and Suchman (1997) refer to the 'culturalist' (NIS) accounts of law and organisations calling:

> Attention to the important role of professional discourses in constructing the meaning of initially ambiguous laws, in determining the situations to which

> legal reasoning applies, and more generally, in advocating for the legality and legitimacy of particular worldviews. (p.499)

In describing the cultural perspective on the regulatory environment (which maps well onto the NIS), Edelman and Suchman (1997) argue that the social construction of meaning often takes place at the organisational field level, which ultimately points to the relationship between law and organisations being 'not so much reciprocally causal as endogenously coevolutionary' (p.501). Karayan and Swenson (2007) describe tax rules as 'social constructs resulting from political processes' (p.30) which are essentially a combination of official and unofficial actions taken by different government representatives over time. Such social construction (through dialogue, litigation and so on) thereby explains the transition from 'law-on-the-books' to 'law-in-action'[92] which has significant explanatory power in the context of this study (particularly in relation to Research Question Four). Edelman and Suchman (1997) see this as a rather messy process, whereby the legal rules and organisational practices move 'in tandem' and 'as the underlying belief system permeates both the legal and the organizational worlds, the boundaries between these realms become increasingly ambiguous.' (p.502) Similarly, Suchman and Edelman (1996) describe the relationship between organisational practice and legal mandate as one which 'evolves collectively over time, may be collaborative rather than confrontational, and involves normative and cognitive as well as instrumental dynamics' (p.922). They also state: 'the law is made as it is enforced, often with as much input from those who are its targets as from those who are its custodians' (p.934).

[92] The focus on law-in-action is within the law and society tradition of research according to Suchman and Edelman (1996).

The institutionalised relationships among the social actors within an organisational field (upon which an organisation can rely) have been identified as a resource termed 'social capital' (Covaleski et al., 2005). They identified the hiring of a former Revenue official (an external social actor) as being an essential part of a company's strategy in helping to 'orchestrate the company's efforts.'[93] This person brought real knowledge to the table but was also (and, arguably, more cynically) a part of the 'impression management' exercise being undertaken by the company. For both reasons, he and the company he worked for held and exercised this 'power' in advancing their vested interests, their action representing the 'strategic manipulation of institutional logics by skilled entrepreneurs' (p.144). Another source of power demonstrated in this case was the 'threat' that if the company did not essentially get what it wanted, it would have to withdraw company expansion from that region and instead expand it elsewhere. I revert to the potential of this use of power in my findings.[94] This study responds in the tax domain to the call of institutionalists (DiMaggio and Powell 1991a, and 1991b) to investigate and probe the manipulation of institutional logics (around dealing with uncertainty, of any size, on the meaning of tax laws) by skilled entrepreneurs (experienced and sometimes highly influential tax executives within and outside an organisation).

[93]This study demonstrated how a Tax Incremental Financing programme was manipulated by the regulated company through its strategic action. This official was the architect of various state policies when working with the Revenue.

[94] Some MNCs in this study, for example, have the power to come to governments using the 'carrot' of employment creation as a bargaining tool for, inter alia, securing a favourable tax regime.

In contrast, the notion of 'symbolic capital' put forward by Covaleski et al. (2005) refers to a form of power:[95]

> Linking the various forms of capital available to an organisation by exploiting inherent defects in their logics; controlling the language used within the field of social actors, strategically redirecting key definitions, and shaping the social setting to serve vested interests. (pp.3-4)

Whatever source of power is used by companies when negotiating on the meaning of laws, Covaleski et al. suggest:

> [W]hat is needed is the resolve of politicians at multiple (e.g. local and state), reinforcing levels of government who are unafraid of face to face confrontations with regulatees (Frug, 1984), and who will back government agencies in the enforcement of legal provisions of whatever level of specificity is applied in order to make New Public Management efforts work. (p.143)

Interestingly in this case, where uncertainty of the law was expected to be at a minimum, the resolve of the company and its CEO resulted in outcomes that did not reflect 'the form abided by the letter or spirit of the law as written'. Importantly, they conclude that 'the construct of uncertainty is a rich and multi-faceted variable which lies at the core of many complex organisational and political relationships characterising the New Public Management' (p.143).[96] Is uncertainty within tax legislation in itself therefore, effectively a source of power? This is the view of Picciotto (1995) as noted in section 1.3.

Covaleski, Dirsmith and Weiss (2007b), in demonstrating the endogeneity of law process, highlight not only the role played by regulatees in shaping the meaning of

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[95] The authors draw on Bourdieu and Waquant's (1992) conception of capital.

[96] The new public management literature has not been addressed in this study as empirically the focus is on the private sector perspective.

the laws they are governed by, but also how 'regulators anticipate this regulatee response and seek to contain its effect in their strategic development and implementation of new regulations' (p.1). The latter, which they describe as a 'second order effect', suggests essentially some form of pre-emptive strike on the part of the regulator being built into the process, which in itself signifies a negotiation process, and sets the scene for an interesting and insightful perspective to be gained in relation to how 'shared meanings' of tax laws, and appropriate processes and practice, might come to be in the tax organisational field. This second order effect may well come into play and be facilitated in the context of new tax laws during the period between a government announcement around some new proposed tax laws and their being enacted.[97]

The influential micro-economic-based Scholes and Wolfson paradigm (1992) (see section 2.2.4), as noted by Roberts and Bobek (2004), 'fails to recognize the state as a negotiable contracting party and the structure of tax accounting laws as endogenous to a corporation's tax planning activities' (p.566). While their study does not draw upon NIS or endogeneity of law literature, they do conclude that companies 'engage in political activities in order to influence the structure of tax accounting laws under which their corporations must operate' (p.567).[98] My study examines the nature and impact of such political activity in relation to tax laws generally and pursues an alternative theoretical perspective as described in this section.

[97] In Ireland for example this can be as long as five months.
[98] They draw on pluralist and Marxist theories and employ a different methodology, based on reviewing secondary data and conducting regression analysis.

Clearly the call for law and society scholars to engage with NIS scholars (Suchman and Edelman, 1996) is recognised and welcomed by the NIS theorists.

Scott (2001) posits that institutional theory will 'benefit greatly by continuing to cultivate connections with law and society scholars..., students of society and accounting...all of these communities bring theoretical insights and useful methodologies to our understanding of institutions and institutional change processes.' (p.199-200) Incorporating the endogeneity of law construct in this study, in which interviews are conducted at the organisational level, is also a response to Roberts and Bobek (2004). 'Organizational level studies are needed to investigate the motivation and execution of managerial strategies that are undertaken to influence tax laws' (p. 587).

The next section addresses the extent to which NIS has been applied to research in the accounting and taxation domains to date.

2.3.5 Institutional Theory in Accounting and Taxation

Institutional theory has certainly received significant attention in the accounting domain over the last twenty years, and continues to do so, both in terms of theoretical-based and empirical-based publications (Covaleski et al., 1986; Burns and Scapens, 2000; Baxter and Chua, 2003; Moll, Burns and Major, 2006). These publications address the three strands of institutional theory recognised in the literature (DiMaggio and Powell, 1991a; Hussain and Hoque, 2002; Moll et al., 2006), namely old institutional economics, new institutional economics and NIS.[99] The focus of this study is NIS and this section presents a brief overview of a number of papers which draw on NIS to a large extent, and alludes to their potential relevance to this study, as appropriate. It is important to recognise support for the NIS perspective in the accounting domain. For example, Carruthers (1995) stated 'the new institutionalism has much to offer those interested in accounting' (p.326), and Baxter and Chua (2003)[100] present NIS as one of seven main perspectives that have flourished as alternative approaches to management accounting research. Moll et al. (2006) position institutional theory (including NIS) as a popular choice for studies in accounting, and they provide a detailed, yet not exhaustive, review of accounting studies which have through this perspective sought 'to understand why accounting becomes what it is, or is not' (p.183). In relation to NIS specifically, they noted:

> Scholars have used NIS insight to explain how the adoption of particular accounting systems can be understood in terms of a need to conform to external pressures as opposed to an overriding (rational-optimising) drive for increased internal efficiency. (p.187)

While such a review is clearly not the purpose of this section, the papers referred to here provide clear evidence of the explanatory power of NIS to help understand how the practice and process of tax planning has become what it is, or is not, in MNCs. As can be seen from this review and others, as referred to above, NIS has received very

[99] See DiMaggio and Powell (1991a) and Moll et al. (2006) for a comparison of these three institutionalisms. As noted by Moll et al., 'NIS and OIE approaches both offer a wide range of applicability for understanding the practice of accounting in organisations and share several traits in common' (p.188).

[100] This article refers to some of the same key authors in this area as identified in this study, namely DiMaggio and Powell, Meyer and Rowan, Covaleski and Dirsmith etc. It focuses on alternative management accounting research in AOS from 1976 to 1999.

little attention in the taxation domain to date. Application of the NIS perspective in this study therefore is a contribution to the NIS and taxation literatures.

Hines, McBride, Fearnley and Brandt (2001) focus on legitimacy when examining the work and effectiveness of the Financial Reporting Review Panel (FRRP) in the UK.[101] Eden, Dacin and Wan (2001), Carpenter and Feroz (2001), Hussain and Hoque (2002) all focus primarily on identifying and explaining isomorphic forces in different contexts. Eden et al. (2001) develop a model of cross-border diffusion of standards (isomorphism) drawing on NIS and the logic of embeddedness (time: who follows and when; motivation: why follow; form-perfect or imperfect diffusion) and transactional interdependence.[102] They draw attention to the fact that 'institutional isomorphism has been much less studied at the international level' (p.2). The idea of who follows and when is of particular relevance in a tax planning context, noting their proposition that 'fast followers adopt the standard for performance reasons whereas latecomers adopt for legitimation motives' (p.5).

Carpenter and Feroz (2001) integrate NIS with resource dependency theories to explore how institutional pressures on four state governments influenced their decision to adopt/resist the use of general accounting principles (GAAP) for external

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[101] Hines et al. conducted content analysis on the FRRP's annual reports and identified six potential myths. They then carried out semi-structured interviews with company directors and audit firm partners. Overall evidence suggested that the FRRP is an effective regulator although some 'myth building' was also found to have taken place by the FRRP. They focussed very much on 'legitimacy' and noted that perceived legitimacy may depend somewhat on the organisation's ability to project the myths about itself and that 'an organization is designed and functions to meet social expectation in so far as its operations are visible to the public' (p.62).

[102] They apply the model to the evolution and diffusion of the arm's length standard within North America from 1917 to the present.

financial reporting.[103] They also reported a decoupling of the budgetary decision-making process from the external financial reporting process (post GAAP adoption) evidencing their conclusion that GAAP is 'a symbol of legitimacy in the public sector' (ibid, p.593). When reviewing literature on mimetic isomorphism they interestingly state that 'uncertainty can be a powerful force that encourages organizations that are viewed as being successful in their organization field' (p.571). This has obvious implications for tax planning due to the uncertainty of some pieces of tax legislation and the idea that drafting (tax) law is fallible (McBarnet, 2001a).

Hussain and Hoque (2002),[104] found that several *institutional forces* influence a bank's performance measurement system.[105] Soin, Seal and Cullen (2002) were concerned with the role of management accounting in organisational change.[106] They draw heavily on the work of Burns and Scapens (2000) using a model of institutionalisation with an old institutional-economics perspective. Significantly

[103] Interesting pressures looked at here included resource dependence, activity level in professional associations (which facilitates early education process) and the role of powerful interests, all of which represent pressures coming from within and outside an MNC influencing approaches to tax planning (see Chapters Four to Seven inclusive). While their study was conducted in the public sector, the case studies revealed findings of relevance for the private sector too, with particular reference to the tax planning function. For example, profound influences were 'personal beliefs of key organizational decision-makers, organization imprinting and culture, professional accounting education programs, and institutional pressures for change emanating from the credit markets.' (p.567)

[104] They focused on non-financial performance measurement practices in Japanese banks.

[105] Ten areas of focus and/or influence were included in their NIS-based framework: economic constraints, competition, copying best practice from others, central bank's regulatory control, accounting standards/financial legislation, socioeconomic-political institutions' pressures, professionals, top management/corporate culture, organizational strategic orientation and organizational characteristics. All of these would fit into Dillard et al.'s (2004) framework referred to later in this section.

[106] They report on a longitudinal study of implementation of activity based costing system in a bank.

however, they draw on NIS for 'important extra features' (p.253).[107] Importantly, in terms of positioning this research in the field of institutional theory, they state, 'the particular version of institutional theory that we drew on, enabled us to explore the *micro-processes* of the organization rather than the influence of the more *macro-level* structures that are often associated with institutional theory' (p.269).

Chung, Gibbons and Schoch (2000) address control issues related to three major flows among MNC subsidiaries namely, knowledge, product and capital flows. MNC literature is drawn upon which, central to my research, highlights the importance of applying alternative theories and will thereby 'gain greater understanding of the complex social issue surrounding controls in MNCs' (p.648) and 'further enrich our understanding of the organizational complexities of the modern MNC' (p.663). Tax planning is one such organizational complexity. Noting the possibility that mimetic and normative forces of isomorphism may be getting stronger in MNCs, Chung et al. posit 'this may be particularly true in the accounting and control arena where professional norms, certification, and continuing education diffuse "best" control practices rapidly' (p.662).

An important theoretical contribution, with particular relevance and applicability to my study, was provided by Dillard et al. (2004). In their attempt to expand the focus of institutional theory, they develop a framework of the context and processes

[107] Various interrelationships (with other agents of organisational change) are explored and the authors evaluate the organisational change, drawing on its dichotomies of formal versus informal change, revolutionary versus evolutionary change, and regressive versus progressive change (see Burns and Scapens, 2000).

associated with creating, adopting and discarding institutional practices. Their framework incorporates institutional theory and structuration theory, is underpinned by the sociology-based institutional theory used by Barley and Tolbert (1997) and draws on the previous work of Clegg, DiMaggio and Powell and Weber. Their framework contains three levels of social systems, namely, economic and political, organisational field and organisational level. It integrates institutional dynamics and the context of institutional practices, and is a rather holistic representation of the institutionalisation process. The recursive nature of the process is very important, resulting in 'a significant degree of structural stability enabling and constraining action' (p.513). It is also the key to understanding 'change in the institutionalised process since taken-for-granted norms, values, beliefs and assumptions may be continually revised at all three levels of the model' (p.514). They believe the advantage of the new sociology-based approach (NIS) is that it facilitates the consideration of the 'social, political and economic aspects that make up the context within which an organization functions' (p.511). They refer to the call made by Miller in 1994 for accounting scholars to refocus their efforts towards the better understanding of how accounting influences, and is influenced by, a 'multiplicity of agents, agencies, institutions and processes' (p.506). Dillard et al. posit that their framework does this and provides a better understanding of institutions, accounting practices and change processes. It explicitly recognises the political nature of institutional change (both incremental and radical) and provides a basis for a more complete understanding of the dynamics involved in such a change.

Dillard et al. (2004) posit that institutional theory has heretofore treated institutionalisation as an *outcome* whereas their framework focuses on it as a *process* which is political, thereby 'reflecting the relative power of organized interests and the actors who mobilise around them' (p.510). They pitch Burns and Scapens' (2000) work at the organisational level but they maintain it is limited in recognising the higher levels (social, political and economic) that influence and define the organisational context. Neither does it address the ways and means by which the organisational level may influence the institutional context at the other levels. The latter represents the recursive nature of their framework. Dillard et al. then specify three constructs, namely representation (drawing on the social constructionists' conception of same), rationality and power (drawing on Weber). They use these 'axes of tension' to describe the domain content of their institutional analysis and thereby operationalise the three levels of their framework. *Representation* concerns the way reality is framed or symbolically described. *Rationality* provides the legitimating conditions for evaluating criteria and practices. *Power* refers to the means and degree of control over human and material resources.

Hopper and Major (2007) in their study of why a Portuguese telecommunications company adopted activity based costing and the consequences of this drew substantially on Dillard et al.'s (2004) framework (see section 3.4 for further details on this framework and how it has been drawn upon in this study's conceptual framework), extending it further by triangulation with other theories to encapsulate all of their observations.[108] Dillard et al. (2004) concluded that 'given its emerging dominance in the organization theory literature, we expect to see an increase in institutional theory-based research that addresses accounting related organization and social issues' (p.533). The tax planning research which is the subject of this thesis goes some way to meeting this expectation.

2.4 Summary

This chapter consisted of a review of three strands of literature: tax planning, new institutional sociology and endogeneity of law. Core aspects of each of these strands of literature are drawn upon to construct the conceptual framework which provides the theoretical lens through which the findings of this research are analysed and discussed in Chapters Four to Seven inclusive.

A major 'gap' in the tax planning literature was identified (section 2.2), namely, a need to understand how organisations create, formulate and administer their tax plans i.e. tax planning in practice. Other 'gaps' in this literature were identified, concerning for example, the area of research methodology. While the literature reviewed is clearly interdisciplinary and comes from a diverse range of academic disciplines (for example, accounting, law, organisational theory), very distinctive themes emerged, which provided the impetus for the structure of the tax planning literature review presented here. Many aspects of this literature were drawn upon when constructing the interview schedule, and will be revisited in the course of analysing the findings.

[108] Theoretical triangulation was achieved through integrating economic, labour process and actor network theories.

Section 2.3 described the core concepts within NIS, drawing primarily, although not exclusively, on seminal literature primarily, although not exclusively in the sociological/organisational theory domain. Section 2.3.3 set out an extended NIS perspective which deals primarily with what is, by now, a recognised shortcoming of earlier NIS-based research i.e. the role of power and politics. Section 2.3.4 reviewed the pertinent literature on the endogeneity of law construct representing a theoretical extension of NIS and a form of theoretical triangulation being applied in this study. Finally, section 2.3.5 provided a brief review of literature in the accounting/taxation domain which has drawn on the theoretical underpinnings of NIS.

These strands of literature provided the basis for developing a theoretical framework which is described in detail in the next chapter (section 3.4), along with other key aspects of the methodology employed in this study.

3 Methodology

3.1 Introduction

The purpose of this chapter is to present the four research questions along with their associated objectives, the overall research approach taken to this study, the theoretical framework, data collection and analysis. Section 3.2 presents the research questions and objectives which were formalised following a detailed literature review and consideration of the findings of exploratory interviews undertaken at the early stages of this research. Section 3.3 addresses the overall research approach taken to this study drawing on five basic research concepts: methodology, method, domain, theory and hypothesis. This study adopts an interpretive approach, the rationale for which is presented in section 3.3.1. The potential for such an approach to enhance our understanding of tax planning in practice is emphasised. Section 3.3.4 addresses the multiple theoretical approach adopted by drawing on theoretical constructs from tax planning, NIS and endogeity of law literatures. Section 3.4 presents the framework in two stages. The first stage (section 3.4.1) provides a descriptive framework of the tax arena, and the second stage (section 3.4.2) presents the core theoretical constructs underpinning this study. Section 3.5 explains how the companies and interviewees that participated in this study were selected. Section 3.6 describes how the interview schedule was constructed and highlights various aspects of the interview process itself. Section 3.7 addresses data analysis and section 3.8 highlights some limitations of this study.

3.2 Research Questions and Objectives

This study examines the practice and process of tax planning in MNCs. Specifically, it addresses four research questions. In order to operationalise this research these questions were considered in the context of a number of discrete objectives, which were arrived at after detailed consideration of the research questions themselves, findings from the exploratory interviews and the literature informing the theoretical framework.

The four research questions and their associated objectives are as follows:

Research Question One: How is the tax planning function organised and conducted in MNCs?

Objectives:

- To establish who manages and provides the tax planning function within MNCs; what are their backgrounds; what is the structure of the tax department; what reporting lines exist; and the implications of such reporting lines on the practice and process of tax planning?
- To examine the importance of tax within MNCs; the existence and formulation of a tax strategy; and its alignment with business strategy.
- To gain an insight into the application of and awareness of the core principles of the Scholes and Wolfson (1992) framework, in their approach to tax planning, namely consideration of all parties, all costs, all taxes and the practice of income shifting.

- To establish who are the internal and external customers of the in-house tax department and to gain an insight into the interaction (in nature and process) between tax and its customers.
- To examine the interrelationship between tax and accounting functions within the MNCs both technically and in an organisational sense.

Research Question Two: How is the performance of the tax planning function measured in MNCs?

Objectives:

- To establish what performance measurements are being used to assess the performance of tax personnel.
- To gain some insight into the process of performance measurement of tax.
- To establish the extent to which any form of benchmarking takes place and how such a process is managed.
- To gain some insights into the extent to which tax performance can be measured.
- To establish whether business units are measured on a post- or pre-tax basis and to understand the interviewees' perspectives on this matter.

Research Question Three: How is tax risk managed in MNCs?

Objectives:

- To establish the main tax risks facing the MNCs.

- To establish whether these companies have a formalised tax risk management (RM) policy and how such a policy (if one exists) is integrated with a company's overall RM policy.
- To gain an insight into how tax risk is assessed and managed in the MNCs in terms of practices and processes.
- To establish what are the greatest recent changes in the tax RM domain and how such changes have impacted (if at all) on the MNCs' tax planning practices and processes.

Research Question Four: What is the nature and impact of the relationship between the tax planning functions within MNCs and the external environment?

Objectives:

- To provide an overview of the constituents/actors of the external environment within which tax executives operates, and their impact on the practice of tax planning.
- To gain an understanding of the practice of and the extent to which US MNCs engage in lobbying activities with a view to influencing tax laws.
- To investigate the extent to which leaders and adoptors exist (or are perceived to exist) in the wider tax community within which the MNCs are operating.
- To gain an insight into the engagement of in-house tax professionals with professional institutes and how this engagement impacts on the practice of tax planning within the MNCs and on tax policy.

- To gain some insight into the 'relationship' between the MNCs and Revenue Authorities, and how this 'relationship' is managed.
- To assess the extent and impact of 'networking' between in-house tax professionals and external tax professionals on the practice of tax planning.

3.3 Research Approach

It is useful to draw on the five basic research concepts described by Ahrens and Chapman (2006)[109] briefly as they apply to this research to describe the overall approach taken in this study. Table 3-1 summarises the position.

Table 3-1 Basic Research Concepts

Concept	Meaning	Application to this research
Methodology	General approach to research	Qualitative
Method	Specific research technique	Interviews, secondary data
Domain	Space where data collection takes place	The Field on tax planning in MNCs
Theory	Explanatory concepts	Tax planning literature, NIS, endogeneity of law
Hypothesis	Testable proposition	Not applicable

[109] As adapted from Silverman (1993).

In relation to the fifth research concept of *hypothesis*, there are no testable propositions being put forward in this research. Such propositions are typically an important element of positivistic studies. In contrast, the interpretive qualitative approach, as is being taken here (see section 3.3.1),[110] 'seeks to explore aspects of social order that are not objectively real but are instead subjectively created through the interaction of actors, rarely mentioning the words hypothesis or testing at all.' (Ahrens and Chapman, 2006: p.5) No further consideration is given therefore to this research concept in this thesis.

3.3.1 Methodological Approach

The general approach taken in this research is qualitative, frequently referred to in the literature as interpretive or phenomenological (Ahrens and Chapman, 2006; Tomkins and Grove, 1983), which places my approach here firmly in Burrell and Morgan's (1979) 'interpretive' box. This approach was decided on after consideration of how best to empirically address the research questions posed in this study. Research questions, theoretical perspectives and data are inextricably linked in any research. In this case, consideration of all three moved somewhat in tandem before concluding that the best fit between these three core aspects of the research would be achieved through a qualitative approach.

[110] Qualitative research can also be undertaken within a positivistic methodology, although this is not common, see Scapens (2004). Subsequent references to qualitative research denote *interpretive* qualitative research.

A qualitative approach is certainly an alternative to positivism and is frequently perceived as being oppositional to it.[111] The latter is based on the ontological assumption that 'empirical reality is objective and external to the subject' (Chua, 1986: p.611), and the former assumes 'social reality is emergent, subjectively created, and objectified through human interaction'(Chua, 1986: p.615). Hopwood (1983), an advocate of qualitative research observed '[w]hat is needed are more substantive investigations orientated towards providing bases for understanding or explaining the working of accounting in action' (p.302-303).

He has repeatedly called for research to study accounting in the context in which it operates, emphasising its wider social and economic context ((Hopwood, 1987), (Hopwood, 1990), (Hopwood, 1999). The four research questions being addressed in this study are concerned with establishing *insights* and *understandings* of various aspects of the process and practice of tax planning in MNCs such i.e. tax planning in action. To gain such insights and understandings a subjective approach is imperative. This approach, which assumes 'organisational activity is meaningful in practice' (Ahrens and Chapman, 2006: p.16)[112] is clearly relevant to the work of tax executives in business as it involves studying the working of tax planning/management in everyday practice. Pursuit of this subjective approach is not at the expense of rigour (as may be argued by positivists) when internal validity is considered at the design and analysis stages of the research, as was the case in my study (see section 3.7). It is

[111]A detailed discussion of the tensions that exist between these oppositional positions was not considered necessary in this thesis. See Denzin and Lincoln (2005), Chapter One, for a detailed discussion of qualitative versus quantitative research.
[112] As drawn by Ahrens and Chapman (2006) from Hastrup (1997).

more a consequence of studying situations and context within which meanings can sometimes be fluid (Ahrens and Chapman, 2006), resulting in what Abernethy, Chua, Luckett and Selto (1999) describe as 'multiple layers/shades of meaning'. For example, the range of answers received from the interviewees suggested a lack of consensus over the meaning of 'tax strategy' and even 'tax planning' itself.

As noted by Lamb and Lymer (2005), rigour and relevance are key research quality assessment criteria. In addressing the possible conflict between rigour and relevance in the realm of management accounting research, Otley (2001) argues in favour of management accounting research which 'connects with real organizations and their practices' (p.246), thereby advocating field-based research methods 'to investigate the wide variety of control mechanisms deployed by organisations in practice which can then be used to generate theory inductively' (p.256). I favour the latter approach in relation to the practice and process of tax planning, predominantly through conducting interviews in the 'tax field'. Through this inductive approach, the findings from this study form the basis for theoretical development and generalisability in accordance with Abernethy et al.'s (1999) position that field research does not aim to establish statistical generalisability but rather theoretical generalisability. Before discussing the other basic research concepts, it is important to consider other research approaches to tax research to locate this study in its methodological context.

Ryan et al. (2002) propose that as taxation researchers often find themselves placed in Accounting and Finance departments it is reasonable to assume that they take on the traditional philosophy of researchers engaged in accounting and finance which was primarily positivistic in nature. Since the 1970s and 1980s however, alternative research traditions in the accounting arena have emerged based on behavioural, organisational and social theories (Covaleski and Aiken (1986); Humphrey and Scapens (1996)); with Tomkins and Grove (1983) contending that accounting researchers were dominated by the natural science approach for too long and need to look to interpretive humanistic approaches to give greater insight into everyday effects of accounting. The interdisciplinary aspect of academic research in taxation is well recognised and means the researcher 'adopts the perspectives and research approaches of more than one academic discipline' (Lamb, 2005: p.7). While many tax researchers are, as posited by Ryan et al. (2002), placed in Accounting and Finance departments, tax research has been conducted as part of a number of research traditions apart from accounting (Lamb, Lymer et al., 2005), namely legal (Freedman, 2005), economic (James, 2005), political science (Radaeilli, 2005) and social policy (Boden, 2005). Due to the changing approaches being brought to research in accounting generally (as noted earlier in this section), and this interdisciplinarity factor, taxation research has attracted researchers with differing ontological and epistemological standings, and this, inter alia has resulted in a disparate mix of quantitative and qualitative research approaches and methods being employed. As noted by Shevlin (1999), '[a]ll methodologies can be found in tax research: namely, experimental markets, behavioural/judgement and decision making, analytical, and archival empirical' (p.427).[113] Hasseldine (2005) points to behavioural studies of tax practice involving experiments, surveys and interviews.[114]

From the very early stages of developing the subject matter of this research, tax planning in MNCs, inspiration was taken from the Scholes and Wolfson (1992) framework. Research conducted in that tradition tends to adopt a microeconomic perspective to 'analyse settings where taxes were likely important' (Shackleford and Shevlin, 2001). Methodologically, the Scholes and Wolfson-inspired research to date mostly takes the positivistic approach, as their framework 'seeks to explain the role and influence of taxes in organizations in a positive and predictive manner' (Macnaughton and Mawani, 2005: p.168). Such research, usually employing highly quantitative research methods has become labelled in the academic accounting literature as 'the microeconomic approach to tax planning' (Macnaughton and Mawani, 2005: p.168). Shevlin (1999) clearly an advocate of such an approach insists 'it is a mistake for doctoral candidates with a tax background to think that they do not need to take advanced econometrics classes' (p.428). Shackelford and Shevlin (2001) call for even more rigorous econometrics to deal with some methodological concerns which they have identified. They also view most of this research as 'documentation' and maintain the move into explanation, understanding and prediction is critical, but slow.

[113] See Table 1 in Shevlin's paper for examples of research from each of these research approaches.
[114] See Lamb et al. (2005) for a discussion on these different approaches also.

While Maydew (2001) expects tax researchers to draw more heavily on Economics literature he also maintains that certain areas of taxation in need of research (such as tax aggressiveness) present an opportunity to engage in qualitative research. I suggest the subject matter of this research is one such area. Overall however, research based on Scholes's and Wolfson's framework tends to be undertaken by researchers who believe empirical reality to be objective and thereby pursue quantitative methods of research to provide a basis for generalisations.[115]

I suggest taxpayers' (individuals or companies) actions do not speak for themselves which would be a positivist view. Taxpayers often behave in the same way for different reasons and this behaviour is not always rational in the economic sense. Their actions need explaining and interpreting in order to be understood. For example, why is tax more strategically aligned in some companies than others? Why are some tax executives more concerned with reputational risk than others? To what extent do companies simply copy their tax planning techniques from others and so on? This study provides findings around these types of issues,[116] enhancing our understanding of the role of taxes in business decisions.[117] Such insights can only be uncovered through the pursuit of an interpretive inductive methodological approach, complemented by a supportive theoretical perspective, and by predominantly employing a qualitative research method, namely face-to-face interviews with the tax

[115] This needs to be understood in the context of North American accounting research generally, which is dominated by the positivistic approach, as discussed by Lee (2004).
[116] Some of which are of concern to Scholes's and Wolfson's (1992) micro-economic-based research also.
[117] Also an objective of Scholes and Wolfson based research. (1992).

executives in taxpaying organizations, as was pursued in this study. Through this process the 'black box' of tax planning activities in organisations is opened up. I do not consider it possible to operationalise all aspects of tax planning (a necessary precondition for a quantitative approach). Arguably, in combining findings from different studies, one taking a qualitative approach (like mine) and another taking a positivistic approach (like Scholes and Wolfson), answers to good questions may be articulated more comprehensively (Black, 2002).

I am not an anti-positivist and see 'qualitative and quantitative approaches as complementary rather than antagonistic' (Thomas, 2003: p.6). However, I believe subjectivity is an essential component of understanding and I would argue that while my professional background (see section 1.2) could be perceived by positivists as being irrelevant, I see it as an asset. It has equipped me to engage with tax executives on a one-to-one basis, to interpret and understand their responses. In support, Williams and May (1996) posit that 'understanding thus begins from commonality' and requires 'empathy on the part of the investigator' (p.63). Ahrens and Dent (1998) posit a researcher's subjectivity as something to be used 'in an attempt to understand what organizational actors have in mind' (p.27). Smith (1998) also acknowledges that 'personal experiences and participation in social institutions all affect the practice of social research' (p.8). The interpretive approach pursued in this research is a reflection of how I see the reality of the tax world and how knowledge of this tax world can best be generated. The latter is influenced somewhat by my professional experiences in tax consultancy. I agree with Smith (1998) that 'social scientific knowledge is shaped by the values and aims of researchers' (p.10).

Overall, the tax world is part of a wider social and economic world which is more complex than the physical world and is of a completely different nature (Rosenberg, 1988). A quantitative approach may well fail to enhance our understanding of the complex nature of taxpayers' behaviour. It provides evidence which may not at times be capable of being communicated to all members of society. The latter, of course, is a desirable aspect of the outputs of social science according to Alfred Schutz (Smith, 1998).

3.3.2 Research Methods

Silverman's (1993) second basic research concept is *research method.* The primary research method employed in this research was face-to-face interviews. While recognising Ahrens and Chapman's (2006) position that interviews can be used with different methodologies 'depending on the notion of reality they are supposed to explore' (p.4), in this case, they were used based on a notion of a social reality (Berger and Luckmann, 1966) of tax planning in MNCs, as opposed to an objective one. The interview method enabled me to work towards an understanding of the social reality of the tax world within which the tax executives are operating and proved to be a rich data source. The use of qualitative methods (including interviews) is consistent with the interpretive methodological approach:

> Qualitative research is a situated activity that locates the observer in the world. It consists of a set of interpretive, material practices that make the world visible. These practices transform the world. They turn the world into a series of representations, including field notes, interviews, conversations, photographs, recordings, and memos to the self. At this level, qualitative research involves an interpretive, naturalistic approach to the world. This means that qualitative researchers study things in their natural settings, attempting to make sense of, or interpret, phenomena in terms of the meanings people bring to them. (Denzin and Lincoln, 2005: p.3)

Interviews have a number of advantages which include: providing the opportunity to probe participants' responses, addressing more complex questions and identifying errors that go undetected when using other research data gathering techniques such as questionnaires (Pedhazur and Pedhazur Schmelkin, 1991). Interviews can range from the highly formalised and structured to unstructured and informal conversation. Patton (2002) describes three different types of interview which may be used: the unstructured interview, the interview which corresponds with the semi-structured interview (Saunders, Lewis et al., 2007: p.312), and the open ended, unstructured interview. Table 3-2 presents three alternative typologies.

Table 3-2 Interview Typologies

	Structured Interview	Semi-structured Interview	Unstructured Interview
Patton (2002)	Standardised open-ended interview	General interview guide	Informal conversational interview
Healey and Rawlinson (1994)	Standardised Interview	-------------------	Non-standardised interview
Fontana and Frey (1994)	Structured interview	Semi-structured interview	Unstructured interview

Source: Fontana and Frey (2005); Healey and Rawlinson (1994); Patton (2002)

The in-depth semi-structured interview guide approach was adopted in this research. It facilitated having a framework of issues/themes around the four research questions and their associated objectives. This approach permitted me some flexibility and spontaneity while keeping a focus on the different themes, and allowed the interviewees 'a degree of freedom to explain their thoughts' (Horton, Macve et al., 2004: p.340). This approach '...helps minimise bias through the prespecification of non-directive questions and probes' (Lillis, 1999: p.87). Probing, used to seek detail and clarity is 'a skill that comes from knowing what to look for in the interview, listening carefully to what is said and what is not said, and being sensitive to the feedback needs of the person being interviewed.' (Patton, 2002: p. 327)

The highly structured interview approach was not considered appropriate as it does not allow the researcher to pursue issues that were not anticipated when deciding on the interview questions (Patton, 2002). Pursuit of the highly unstructured approach would not have facilitated obtaining responses around certain common themes which were developed carefully and purposefully. The interview schedule and process are discussed further in section 3.6.

In addition to interviews, I examined each company's most recently filed (i.e. 2004) 10K.[118] I necessarily examined these 10Ks prior to conducting the interviews. The 10Ks, which includes financial statements, provided important contextual documentary information on the nature of the company's business, the countries in which they have a physical presence, auditors' identity, detailed financial reports and so on. While some valuable information on the companies is available from an examination of the financial reports, real insights into a company's tax situation, or its approach to tax management cannot be obtained in this manner. This view is evidenced by **TE 14**'s comment,[119] 'I better be careful saying this on tape but financial statement disclosures are no more transparent today than they were before. You could not tell what we're doing.'

This calls into question the value and usefulness of accounting statements from many stakeholders' perspectives.[120] It also questions the usefulness of financial statements in terms of explaining and understanding tax planning in MNCs. I also examined the companies' websites, recent company press releases, press comments, and internet accessible executive biographies of the interviewees. In addition, I reviewed some

[118] Form 10K is the annual report that publicly quoted companies file with the U.S. Securities & Exchange Commission. It provides a comprehensive overview of the company's business.

[119] TE denotes tax executive.

[120] Further consideration of which is not within the realm of this particular study.

material on recent legislation which I thought might come into my discussions with the interviewees, the details of which I needed to be familiar with, such as the Sarbanes Oxley 2002 Act, and the Homeland Investment Act.[121]

3.3.3 Domain

In relation to the third research concept of *domain* or space in which research takes place 'the shape of the field depends on its usefulness for answering the research questions' (Ahrens and Chapman, 2006: p.6). Through conducting face-to-face interviews with tax executives in MNCs and tax advisors, I have explored an important element of the 'tax field' with a view to answering the research questions posed in this study.[122] This qualitative field study approach facilitates 'open-ended interaction between the researcher and researched' (Ahrens and Chapman, 2006: p.6). See section 3.5 for the rationale for selecting the companies involved in my study, and section 3.6 for a description of the interview process.

3.3.4 Theory

The fourth research concept is *theory* and the related explanatory concepts. Theory selection is very important as 'appropriate theorization can give fuller explanations of organizational structures and processes than those held by organization members' (Llewelyn, 2003: p.662). The theories and the explanatory concepts employed in this research are encapsulated in stage two of the theoretical framework depicted in Figure 3.2. This framework represents the convergence of theoretical explanatory concepts

[121] Part of the American Jobs Creation Act 2004.

[122] I am aware of the potential limitations of obtaining one side of a story, a point which is addressed in section 3.8.

from tax planning literature, NIS and endogeneity of law, representing theoretical triangulation, i.e. 'using various factors from a variety of theoretical perspectives simultaneously to examine the same dimension of a research problem' (Hopper and Hoque, 2006: p.478). Ahrens and Chapman (2006) posited that 'events in the field may best be explained with reference to multiple theories' (p.5). Drawing on multiple theoretical paradigms lends itself to obtaining a more comprehensive understanding of the practice and process of tax planning in MNCs and 'can help one take advantage of the complementariness of different theories' (Hopper and Hoque, 2006: p.479). I recognise that some of the theoretical constructs drawn in this study from the tax planning literature, particularly from Scholes and Wolfson (1992) informed research (e.g. income shifting), are rooted in opposing epistemological and ontological assumptions to the NIS and endogeneity of law constructs. While such triangulation might be considered somewhat ambitious and not strictly 'within-same tradition' (Hopper and Hoque, 2006), it enhanced rather than constrained the overall interpretive approach taken here.[123] The choice of theory is interlinked with the overall interpretive approach used in this study. In support of the theoretical approach adopted here, Covaleski et al. (1996) posited that IT (encapsulating NIS) has most forcefully developed the core aspects of an interpretive perspective i.e. its concern with social construction and the spread of rationality and how such rationality impacts

[123] Theoretical triangulation has many advocates in accounting research. See Carpenter and Feroz, (1992); Hoque and Hopper (1994); Abernethy and Chua (1996); Covaleski et al. (1996); Ansari and Euske (1987).

the power and politics in organisational functioning. The theoretical framework is discussed in detail in the next section.[124]

3.4 Theoretical Framework

As referred to earlier, this study draws on three strands of literature, namely tax planning, NIS and endogeneity of law literatures (see Chapter Two). The core themes and theoretical constructs within these literatures provide the basis for the theoretical framework developed and presented in this section, which is used and drawn upon in Chapters Four to Seven inclusive, when analysing the findings on the practice and process of tax planning in US MNCs.

The theoretical development within this study consists of two separate integrated stages. The first stage consists of constructing a descriptive framework, which is a useful tool around which and through which to describe and understand the make-up and dynamics of interaction in the broader tax arena and environment within which corporate tax executives must operate. This framework draws heavily on Dillard et al.'s (2004) framework. The second stage brings together the core theoretical constructs as drawn from the three strands of literature referred to above, through which an understanding of the findings of this study will be enhanced, with a particular emphasis on their explanatory power at the organisational level of

[124] Alternative interpretive perspectives, critical perspectives and contingency theory were also briefly considered, but not pursued following a review of pertinent literature on such alternatives (Otley (1980); Covaleski et al. (1996); Chenhall (2003)). I recognise however, that there are some overlaps in relation to core NIS constructs within some of these other theoretical approaches.

analysis.[125] These core constructs were drawn upon when operationalising the interviews conducted at the organisational level (see section 3.6.1 on construction of the interview schedule).

3.4.1 Stage One: A Descriptive Framework of the Tax Arena

As referred to earlier, Dillard et al. (2004) developed a framework of the context and processes associated with creating, adopting and discarding institutional practices i.e. a general institutional model of organisational change. Their framework sets out a dynamic social context within which institutional change takes place. While the primary focus of my study is not on change per se, some insights have been obtained into the process by which change in tax planning activities and tax laws are brought about., the analysis of which will benefit greatly from having from the outset a picture of the broader tax arena, the range of participators/actors engaged in the tax arena, the different levels of analysis at which they operate, and the potential interplay between all of the actors involved. Applying the Dillard et al. framework in an international tax context provides a particularly rich tool for 'setting the scene' and for identifying the players at each level of analysis. This in itself is a valid pursuit, particularly in a study of this nature where the application of NIS in a tax planning context is new.

This framework depicted in Figure 3-1 encapsulates three levels of social systems: the economic and political level, the organisational field level and the organisational

[125] This is very important in the context of this study as almost all of the interviews conducted were with tax executives within the MNCs — the organisational level of analysis in accordance with the Dillard et al. (2004) typology.

level, implicitly representing a hierarchy of institutional influence.[126] For example, 'the societal level sets the dominant ideology for the organizational field to translate into organizational controls' (Hopper and Major, 2007: p.56). Different 'actor sets' exist and are presented at each level in the tax arena, with some being more influential than others. Different roles are played out at each level, ranging from the implementation of tax plans and associated processes at the organisational level, to developing and setting standards of practice at the organisational field level, to developing and enacting tax laws at the economic and political level.

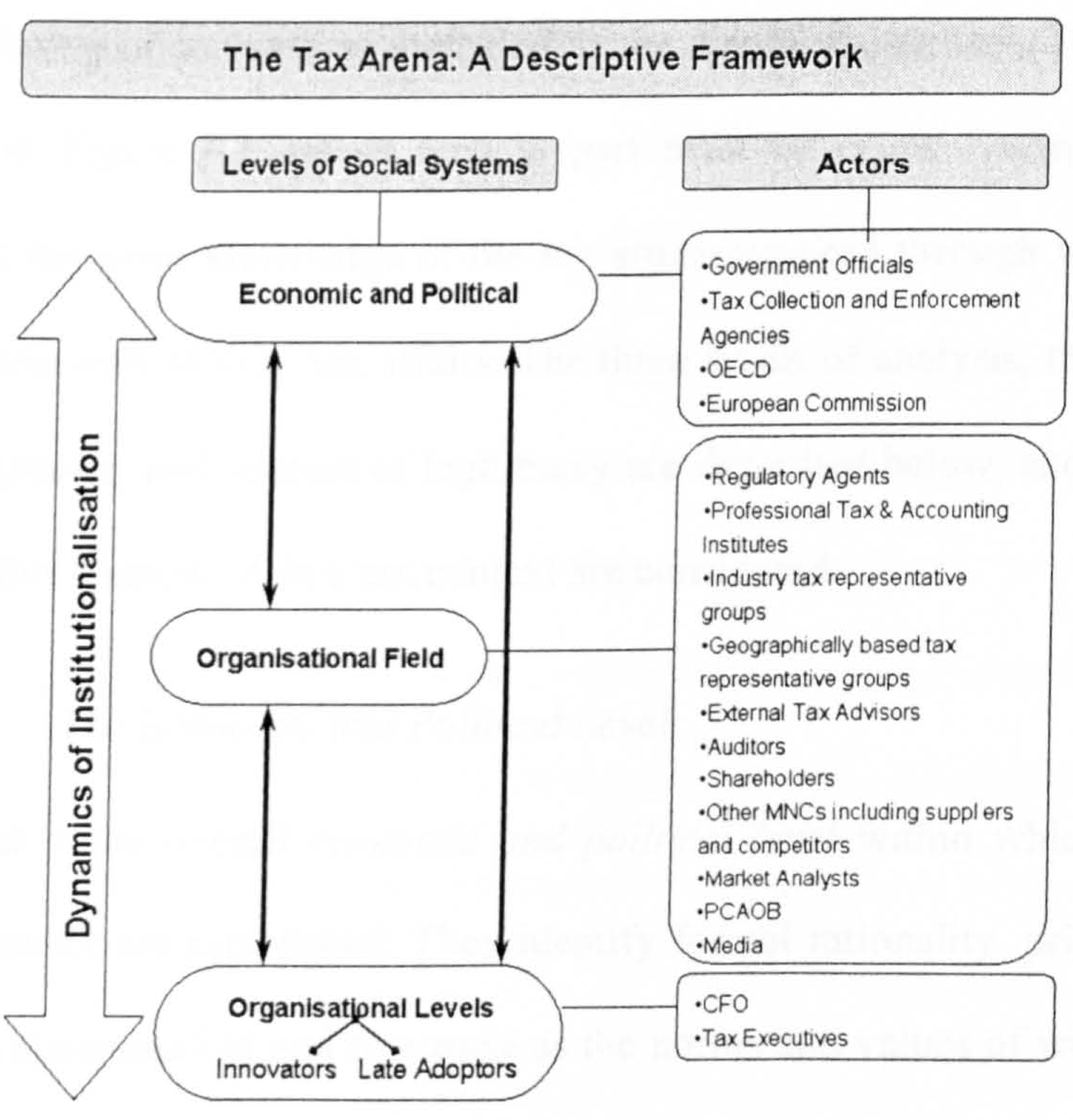

Figure 3-1 Theoretical Framework: Stage One

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[126] These three levels map well onto Fligstein's (1991) 'institutional spheres' representing the three contexts within which organisations operate namely, 'the existing strategy and structure of the organization, the set of organizations comprising the organizational field, and the state' (p.312).

Arguably, they share a common interest in the jurisdiction and legitimacy of the taxation profession as a whole. However it is important to recognise that actors and interest groups at each level are operating in different contexts, have different interests, different sources of power and different audiences to whom their claims for legitimacy must be articulated (Perrow, 1985). There will accordingly be tension and controversy between the different levels around for example, new tax planning practices and processes. My study provides some insight into the nature of such tension and controversy, how it arises in the tax arena and how resolutions are often found. The latter is reflected in the dynamic, dialectic and recursive relationship between the levels of analysis, as indicated by the directional arrows. These actor sets as depicted in Figure 3.1 are sourced in part from interview findings, secondary research, and my prior knowledge of the tax arena acquired through working in tax practice dealing with MNCs' tax affairs. The three levels of analysis, their associated actors and agencies, and sources of legitimacy are described below, and the potential dynamics of this framework in a tax context are considered.

3.4.1.1 The Economic and Political Level

The first level is the overall *economic and political level* within which norms and values of a society are established. They identify formal rationality, private property rights, wealth accumulation and free trade as the norms and values of western market capitalist societies:

> The recursive institutionalization process...can generally be viewed as a process contextualized by the most general and widely taken-for-granted norms and practices accepted at the societal level where political and economic systems...use symbolic sense making criteria...in articulating and instituting legitimate norms and practices. (Dillard et al., 2004: p.513)

The MNCs in SV that participated in this study, being members of such a western market capitalist society, approach tax planning on the basis that a company aspires to and actively engages in tax planning with a view to minimising its worldwide tax bill (and thereby maximise return to its investors). This is the 'norm' and is very much accepted generally at the societal level. Some interviewees spoke of this being a 'taken for granted' starting point, whereby there was no question of tax planning per se being perceived by the wider community as 'frowned upon' or 'illegitimate' practice. Clearly, however, as the findings reveal, some companies engage in different levels of 'risk-taking' in their tax plans, and some arguably take a less patriotic view when putting tax driven structures in place vis-à-vis it giving rise to (more or less) US taxes versus non-US taxes (in absolute terms).

The primary actors at the societal level include government officials, regulators and legislators. As the government of the day can enact and change tax laws, the state can arguably 'alter the environment more profoundly and systematically than other organizations' (Fligstein, 1991: p.315). It can act as mediator and be a source of change or stability. The various tax laws namely the 'elements' of the political and economic system in a tax context, 'represent the properties of the prevailing systems of social integration' (Dillard et al., 2004: p.513). The existence of these tax laws and the (rather simplistic) assumption that all tax planning is 'legal' contributes towards this perception at the societal level of tax planning being legitimate.[127] The practice of tax planning therefore enjoys a strong support from this level. In addition, broadly speaking, it could be said that political systems worldwide, through governments, approve of, support and facilitate tax planning activities by MNCs (by for example introducing tax-based incentives).[128] There is a tension at this level between a government needing to enact tax laws that are 'good for business' which effectively renders it an 'investment partner' (Scholes and Wolfson, 1992), yet satisfy the diverse range of social and economic objectives that are typically part of any programme for government, many of which may not be perceived as 'good for business'. This results in compromise on the part of government in terms of both tax legislation and the implementation thereof. While there are different political and tax governance structures in place throughout the world (and these MNCs operate in many different countries), generally, the primary actors identified at this level in a tax context include government officials such as governments leaders and finance ministers, tax collection and enforcement agencies such as the Inland Revenue Service (IRS) in the US and the Revenue Commissioners in Ireland, the European Commission and the OECD.

3.4.1.2 The Tax Organisational Field Level

As stated earlier (see section 2.3.2.4) the organisational field is possibly the most important and influential level generally in an NIS context and more specifically in

[127] Of course, the attitudes of some tax executives towards dealing with such uncertainties vary which in itself may be problematic in terms of this working assumption at the societal level.

[128] I recognise that within this, the governments are in competition for a revenue base, but further discussion on this is not directly relevant to this thesis.

the context of understanding the tax arena. DiMaggio and Powell's (1991b) definition is worth restating at this stage: 'Those organizations that, in the aggregate, constitute a recognized area of institutional life: key suppliers, resource and product consumers, regulatory agencies, and other organizations that produce similar services or products.'(p.64)

DiMaggio and Powell (1991b) also alluded to the potential for the influence of the organisational field on an organisation to be even more enhanced when dealing with an uncertain terrain (such as interpretation of tax laws in this instance). Constituents of this group would include professional institutes, industry groupings, and geographical groupings, industry leaders, trade unions and external consultants. Relationships between organisations in the field can be described in network terms according to Fligstein (1991), the nature of which ranges from 'formal relations to personal friendships' (p.313). He goes on to address the issue of stability within an organisational field as being an important variable when addressing change in any organisation positing 'where the rules exist and a pecking order of organizations is well established, fundamental change is less likely' (p.313). Within this level the economic, political and social values referred to above are translated into 'field specific expectations' (Dillard et al., 2004: p.513). Professional tax institutes, other tax representative groups, for example, develop certain 'best practices' in relation to tax planning practice and processes within the economic and political context. Professional associations 'enable the formation and reproduction of shared meanings and understandings' (Greenwood et al., 2002: p.61), and enable organisations to 'collectively attempt to shape institutional requirements and redefine environments' (Scott, 2001: p.152). While recognising the normative aspect of field level activity, Fligstein's (1991) view of it as 'a construction of powerful organizations that is based on the interests of those organizations' (p.314), is also noted and taken into account when analysing the findings in this study.

Some actors, interest groups and representative groups may be more powerful than others in setting such best practice parameters, a point which will be revisited in the findings (Chapters Four to Seven inclusive). From an NIS perspective this is very important as 'the perceived "better practices" are implemented by other organizations within the organizational field and become expected practices (institutionalized)' (Dillard et al., 2004: p.515).

Fligstein (1991) proposes two principles as the bases for certain organisations controlling the field. The first concerns the relative size of an organisation and second recognises that certain actions in practice tend to suit all organisations in the field. For instance, some tax plans and related processes suit all companies in SV, due to the commonalities they face in terms of industry, structure and global challenges 'to the degree that all members benefit from the formation of stable rules governing legitimate actions in the field, cooperation is to be expected' (p.314).

As noted by DiMaggio and Powell (1991b: p.65), 'the structure of an organizational field cannot be determined a priori but must be defined on the basis of empirical investigation'. Based on the findings of this research, the tax field consists of: tax professional associations/institutes such as the Tax Executives Institute; industry specific representative groups such as the Semi-Conductor Industry Association;[129]geographically-based tax representative groups such as the Silicon Valley Tax Directors Group; external tax advisers, auditors, other regulatory agents, tax academics, other MNCs including suppliers, distributors and competitors, financial analysts, the media and others to whom the profession articulates its claims to legitimacy and status (for example shareholders).

Greenwood et al. (2002) identify professional associations as important regulatory agents which 'play an important role in theorizing change, endorsing local innovations and shaping their diffusion' (p.58). The latter reflects their partaking in the dynamics of institutionalisation (Dillard et al., 2004) which takes place by, inter alia: 'hosting a process of discourse through which change is debated and endorsed: first by negotiating and managing debate within the profession; and, second, by reframing professional identities as they are presented to others outside the profession.' (p.59) Such discourse could typically be facilitated through educational programmes and conferences (Greenwood et al., 2002).

While the primary empirical level of my study is at the organisational level, a small number of interviews were conducted at the organisation field level with tax advisors

[129] See section 7.2 for a comprehensive description of all constituents at all levels of analysis.

to MNCs, the findings from which provide another insightful perspective on the process and practice of tax planning.

3.4.1.3 The Organisational Level

This is the individual organisational level i.e. the individual MNCs. The primary actors here include leaders of the tax function (typically a Tax VP, and CFO) and all tax executives within each company. These are the individuals charged with managing the tax function in their respective organisations, which incorporates both tax compliance and tax planning. This is the primary empirical level of investigation in this study as most of the interviewees are senior in-house tax executives. As the findings from this study demonstrate, the 'power' of the tax function varies from one organisation to the next for many reasons, but tends to be influenced hugely by the individuals in key roles who exercise their power through both 'formal and informal authority structures' (Fligstein, 1991: p.313).

These individuals tend to be concerned with their legitimacy both internally vis-à-vis other functions and externally vis-à-vis other tax executives, auditors and tax regulators and so on, thereby providing a rich terrain of tension at this level.

Dillard et al. (2004) incorporate the distinction between innovators and late adoptors, a categorisation with particular relevance in a tax context. Scott (2001) referred to three classes of variables: attributes, linkages and reference groups. These may help identify organisational features associated with early adoption rates which appear potentially relevant in the tax domain, particularly in the context of MNCs adopting the latest tax plan/structure that has been adopted elsewhere in SV. Company size is clearly identified as an important attribute. Scott (2001) draws on studies which linked the characteristics of certain individuals within an organisation with adoption rates, for example CEO background and his/her power vis-à-vis the corporate Board. With respect to tax, the impact of the characteristics of the CFO is worth investigating, as is done in this study. The latter emphasizes the potential power vested in certain individuals within an MNC: '[p]ersonal influence is dependent on the particular unique actor' (Zucker, 1991: p.86). Adoption rates in the tax domain may also be examined through assessing the linkages that MNCs and their tax directors have with other actors in their environment, such as other tax executives and institutes. The third variable, reference groups, raises the question of which organisation to copy or emulate. This is important in the tax context where often the interpretation of tax legislation is uncertain and tax executives arguably may get comfort from the fact that they are interpreting the uncertain tax laws in the same way as certain other organisations have already done, which ultimately may lead to the mentality that they (the 'experts') all cannot be wrong. Factors arising from research in this area as analysed by Scott (2001) include, geographical location (all of the companies in my study are based in SV), company similarity (same industry, often facing many similar tax issues/opportunities), closely tied through for example sharing information, board interlocks, and the impact of the perception of 'successful' or 'prestigious' individuals/companies with respect to tax planning. As noted by Scott (2001), '[t]he arguments associated with these variables range from strictly institutional ones to vicarious learning to political manouvering' (p.168). The findings of this study provides evidence of leaders and adoptors co-existing (often quite harmoniously) when it comes to tax planning practices and processes among MNCs in SV (see Chapters Four to Seven inclusive).

3.4.1.4 Dynamics of the Framework

As stated earlier, the focus of this research was not on tracking change in the tax arena per se, and this descriptive framework is being used primarily as a tool for describing the tax arena in terms of different levels of social systems and the actors and agencies 'at play' at each level. Nonetheless, it should be noted that this framework has significant explanatory power in terms of understanding the institutional relational dynamics between the three levels, particularly in relation to Research Question Four.[130] This model represents the recursive nature of the institutionalisation process, resulting in the context of the tax domain in 'a significant degree of structural stability enabling and constraining action' (Dillard et al., 2004: p.513). As is suggested by the findings of this research, tax laws, while not always liked by business are often 'negotiated', and well anticipated by tax executives, who are often allowed sufficient time, for example between announcement and enactment, to take account of, and/or adjust for, such new laws in their tax plans. The latter of course, presupposes the necessary dynamic aspect of effective tax planning (Scholes and Wolfson, 1992).

It should be recognised that despite the hierarchical representation inherent in this framework, not all organisational fields or indeed organisations will always agree on

[130] These dynamics will be revisited in the findings (Chapters Four to Seven inclusive).

the same values, beliefs and norms which in itself results in friction which ultimately may lead to changes at all levels. Also, organisations sometimes deal with very different internal and external pressures. Whatever the dynamics involved 'recursivity is the key to understand change in the institutionalization process since taken-for-granted norms, values, beliefs and assumptions may be continually revised at all three levels of the model' (Dillard et al., 2004: p.514).

There are vested interests at all levels of analysis, from the political leaders, to representative groupings, to individual corporations and to individuals within these corporations. Arguably, it remains in all of their interests to maintain an acceptable and workable level of stability and change within the broader tax environment. Fligstein (1991) referred to one great cause of stability being in 'the interest of any given set of organizations and the actors in them in maintaining some distribution of power and resources' (p.314).

Notwithstanding the hierarchical representation inherent within this framework, importantly, this study demonstrates clearly that actors at all levels engage with actors at the other two levels. Individual tax executives engage with their representative groups at the organisational field level. They engage with actors at the political level either indirectly (for example through having views on some tax law related through a representative lobby group), or directly when for example, meeting with a finance minister of a country into which the company is considering putting a new plant. The framework therefore, represents a complex web of interaction between the three levels. This study provides insights into the dynamics of interaction between the different levels, highlighting various points of tension. For example, how and to what extent do professional institutes set norms within tax planning, and to what extent are such norms adhered to in practice? Is there some evidence of decoupling or loose coupling of such norms when it comes to tax planning practice and processes in action? (Meyer and Rowan, 1991) This gives rise to interesting questions around who sets the agenda at the field level and the embracing (or not) of this agenda at the organisational level. The interviewees are themselves (or one of their tax team) members of many different representative groups, all of which have similar and varied agendas. Managing one's interaction and relationship with these different groups in itself appears to be something of a challenge, particularly when the different agendas do not coincide. The latter is also explored further in Chapter Seven.

While Dillard et al. (2004) in developing their framework were focused on expanding institutional theory, it is important to remember that it embraced the core theoretical constructs within NIS, including the recent calls for consideration of power and politics all of which were described in Chapter Two. These core theoretical constructs constitute the lens through which the findings in relation to all four research questions are analysed. In relation to Research Question Four however, there is also a critical link between the extension of NIS being pursued in this study to take account of the endogeneity of law construct (see section 2.3.4) and the 'dynamics of interaction' typology within the Dillard et al. (2004) framework when describing the process of institutionalisation. While Dillard et al.'s 'dynamics of interaction' has explanatory power in relation to all four research questions, its alignment with the endogeneity of law perspective is particularly noteworthy in relation to Research Question Four. These two theoretical approaches combine well and together provide a very rich platform from which to explain and understand the findings in relation to Question Four. Section 2.3.4 referred to the conceptual link between the endogeneity of law literature and the writings of McBarnet/McBarnet and Whelan (as referred to in section 2.2.4 when reviewing the tax planning literature). Following on from this, there is also a conceptual link between their writings and Dillard et al.'s 'dynamics of interaction' particularly with respect to the role of the regulated in actively resisting tax laws.

3.4.2 Stage Two: Core Theoretical Constructs

Stages one and two of the theoretical framework are inextricably linked. Stage one, as represented in Figure 3.1 provides a descriptive framework which sets the scene of the tax arena in terms of three levels of social systems, the various actors at play at each level and the dynamics of institutionalisation in the tax arena through a complex web of interaction between actors at the different levels of analysis. Stage two, which is addressed in this section brings together the core theoretical constructs from three strands of literature: tax planning (section 2.2), NIS (section 2.3) and endogeneity of law (section 2.3.4), through which the practice and process of tax planning in MNCs and the dynamics of institutionalisation in the tax arena in SV are analysed.[131]

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[131] While the former two strands of literature are drawn upon conceptually in relation to all four research questions, the endogeneity of law literature is of most relevance in the context of analysing the findings in relation to Research Question Four only.

Stage two of the framework is diagrammatically represented in Figure 3.2. As the above three strands of literature have been reviewed thoroughly in Chapter Three, they will be revisited only briefly here as the context requires.

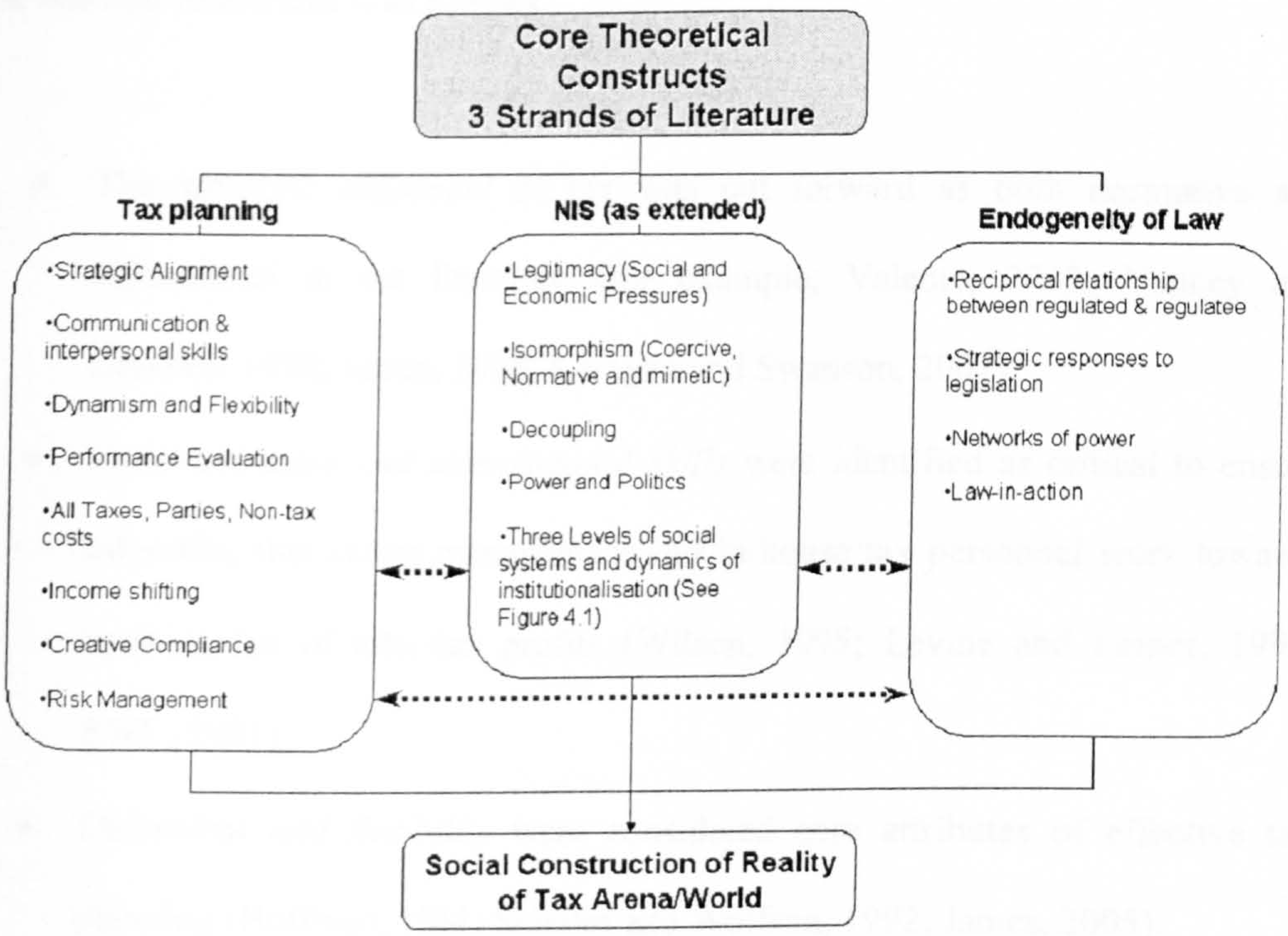

Figure 3-2 Theoretical Framework: Stage Two

3.4.2.1 Tax Planning

This literature makes two distinct contributions to the study. Firstly, it was drawn upon when deciding what aspects of the tax function to discuss with the interviewees (see section 3.6.1). These aspects of the function emerged as central themes and were the basis on which my literature review was presented earlier (section 2.1). The second contribution is by way of some rich theoretical constructs which now constitute an important part of this stage of the theoretical framework as represented in Figure 3.2.

The key theoretical constructs are drawn from tax planning literature which principally addresses normative attributes of effective tax planning, and a sample of the relevant references is as follows:

- The *strategic alignment* of tax was put forward as both normative and aspirational in the literature (for example, Valente, 2002; Yancey and Cravens, 1998; James, 2005; Karayan and Swenson, 2007).
- *Communication and interpersonal skills* were identified as critical to ensure inter alia, that senior management and in-house tax personnel work towards optimisation of after-tax profits (Wilson, 1995; Levine and Lerner, 1993; PWC, 2001).
- *Dynamism and flexibility* were considered core attributes of effective tax planning (Hoffman, 1961; Scholes and Wolfson, 1992; James, 2005).
- *Performance evaluation* of the tax function was broadly considered important and necessary, though little consensus exists on how best this can be carried out (Douglas and Ellingsworth, 1996; Rego, 2003; Phillips, 2003).
- *All taxes, all parties and all non-tax* costs should be considered as part of any effective tax planning (Scholes and Wolfson, 1992; Wilson, 1993; Yancey and Cravens, 1998).

- *Income shifting* is advocated by many as an effective form of tax planning (Scholes and Wolfson, 1992; Samson, 1998, Fallan et al., 1995).
- *Creative/innovative* approaches to tax planning discussed in the literature, whereby adherence to the strict letter of the law is of more concern than adherence to the spirit of the law (McBarnet, 2001a, 2001b, Fallan et al., 1995).
- The need to have and exercise a tax *risk management* policy, dealing with operational, planning and compliance risk is extremely important in the context of operating within what is sometimes an uncertain legal environment (Hoffman, 1961; PWC, 2001).

All of the above are captured in Figure 3.2 and findings are provided in this study with reference to these normative principles from the literature on tax planning.

3.4.2.2 New Institutional Sociology

The core theoretical constructs within NIS (as extended in this study: see sections 2.3.3 and 2.3.4) provide a particularly rich lens through which to analyse and discuss the findings pertaining to all four research questions in this study. These constructs and a sample of the relevant references are as follows:

- *Legitimacy* is a core concept within NIS and is rooted in the idea that, in order for organisations to survive in their social environment they need to be socially acceptable and credible. Achieving legitimacy in the eyes of the world, the professions and so forth, is extremely important and valued (Scott, 2001; Powell and DiMaggio, 1991; Carruthers, 1995). An important theoretical progression (see section 2.3.2.1) recognises the co-existence or interaction between social and economic pressures, whereby efficiency concerns and institutional processes are not oppositional (Scott and Meyer, 1991; Powell, 1991; Hopper and Major, 2007). This framework therefore takes account of both social and economic sources of legitimacy, with however, a greater focus being given to the social sources when discussing the findings.

- Institutional *isomorphism* constitutes the adaptation of institutional practice by an organisation. Three classifications (although not mutually exclusive) are recognised in the literature: coercive, mimetic and normative (Meyer and Rowan, 1991; DiMaggio and Powell, 1991b; Covaleski and Dirsmith, 1988; Scott, 2001). My study provides evidence of all three sources of isomorphism in action in the SV tax arena.
- *Decoupling* which refers to the situation in which the formal organisational structure or practice is separate and distinct from actual organisational practice. The resulting formal structures may well be in conflict with efficiency criteria. (Meyer and Rowan, 1991; Scott, 2001; Carruthers, 1995).
- *Power and politics* is an extension of the NIS perspective (Perrow, 1985; Covaleski and Dirsmith, 1988; Dillard et al., 2004; Hopper and Major, 2007) and is incorporated in this framework to capture the role of powerful actors inside and outside of their organisations.
- Three levels of analysis or *levels of social systems* and the associated *dynamics of institutionalisation* are well recognised within the NIS literature

(Dillard et al., 2004; Hopper and Major, 2007). These are incorporated in Figure 3.2, where they are cross-referenced to Figure 3.1, in which they are described in detail (see section 3.4.1 also).

3.4.2.3 Endogeneity of Law

As described in section 2.3.4, this perspective pays attention to active agency and the play of power and politics in the context of understanding the social construction of the meaning of tax laws, and helps explain the transition from 'law-on-the-books' to 'law-in-action'. In their strategic responses to tax regulations (Oliver, 1991), and through various networks of power, organisations frequently play a role in the construction of the law that regulates them (Suchman and Edelman, 1996; Edelman and Suchman, 1997; Covaleski et al., 2007b). There is thereby a reciprocal relationship between the regulator and the regulatee reflecting a political process around the making and implementation of tax laws, which is an important aspect of this framework as depicted in Figure 3.2.[132]

Suchman and Edelman (1996) refer to the inherently ambiguous nature of law creating:

> Room for manipulation, interpretation, and enactment on the part of actors both within and outside of organizations...Indeed the social construction of legal threat can become a primary vehicle by which individuals, subunits, and

[132] See Suchman and Edelman (1996) for their views on what NIS has to offer the law and society tradition, providing new insights on understanding compliance with the law, specifically '[d]epicting legal compliance as institutional isomorphism recasts law as a broad cultural framework that influences organizations both mimetically and normatively, not merely through coercive material incentives.' (p.920)

professions and advance their own status. (p.935)

As referred to earlier there are conceptual alignments between some aspects of the tax planning literature (McBarnet, 2001a; McBarnet and Whelan, 1992), the dynamics of institutionalisation (Dillard et al., 2004) and the endogeneity of law (Suchman and Edelman, 1996; Edelman and Suchman, 1997; Edelman et al., 1999; Covaleski et al., 2007b) literatures which is represented by the dotted line in Figure 3.2. Finally, this diagram depicts the social construction of the reality of the tax arena which the findings of this study supports. These are interpreted through the lens of NIS (as extended), endogeneity of law perspectives and tax planning principles.

3.5 Selection of Companies and Interviewees

This study focuses on the practice and process of tax planning in US MNCs in the information technology (IT) sector. The headquarters of all of these companies are based in the SV area of California (see section 1.3 on SV).[133] US MNCs were chosen in 2002 for a number of reasons. There was (and still is) a significant number of US MNCs operating in Ireland.[134] US investment in Ireland continues to be extremely important to the Irish economy. In 2001, when the companies studied were selected, 1,240 overseas companies had a base in Ireland. Forty three per cent of Industrial Development Authority-assisted overseas companies in 2001 were US MNCs (PricewaterhouseCoopers, 2003). This figure was in excess of 46% in 2002

[133] Although one company has a Cayman Islands-based tax structure. In this context it is interesting to note Hines' (1999) point: 'It is striking that, in spite of the appeal of low tax rates, very few multinational firms actually relocate their corporate homes to tax havens. In part, this reflects the tax and regulatory costs of doing so, but in part, it also reflects the unwillingness of governments to impose excessively heavy tax burdens that encourage widespread departures' (p.313).

[134] I am a lecturer at the National University of Ireland, Galway and have therefore a natural interest in all companies operating in Ireland.

(American Chamber of Commerce Ireland, 2003). According to American Chamber of Commerce Ireland (2003), in April 2003 'there are 570 US companies, employing over 90,000 people in Ireland. US Foreign Direct Investment is valued at over $34 billion'. The then Irish Minister for Enterprise, Trade and Employment reinforced the importance of US companies in Ireland as she believed 'US investment is crucial to Ireland's current and future success, both as an investor and a significant trading partner' (American Chamber of Commerce Ireland, 2003).

In 2000 and 2001, in excess of 50% of the total Irish corporation tax yield came from manufacturing and internationally traded services companies (Forfás, 2002, 2003). I have spoken with a member of personnel working in the statistics section of the Irish Revenue Commissioners who provided this information and she is very firmly of the view that a significant proportion of these manufacturing and internationally traded services companies are in fact US MNCs. Accordingly, this group of taxpayers are and I expect will continue to be of great importance to the Irish Exchequer. US MNCs continue to be attracted to Ireland due to, inter alia, Ireland being one of the most profitable locations in Europe for overseas investors.

Many US MNCs have centralised their European/worldwide finance and tax functions in Ireland. The latter facilitated to some extent my getting access to the relevant tax experts within the companies finally selected. US MNCs operate in many jurisdictions throughout the world and accordingly have many and varied tax issues to address on a worldwide basis. There is a prima facia need for tax executives within these companies to understand the business and its organisation in order to effectively create, formulate and administer tax plans. Equally, there is a need for non-tax managers to be aware of the potential role of taxes when structuring business activities and transactions. Choosing US MNCs is a deliberate attempt to seek out companies and individuals engaged in the processes being studied. This 'purposive sampling' approach is a common technique employed by many qualitative researchers (Miles and Huberman, 1994: p.27).

US MNCs invest heavily in tax planning activities (Scholes and Wolfson, 1992). There is evidence to suggest that this investment is economically worthwhile. Mills et al. (1998), who examined the tax related expenditures of 365 large US corporations, estimate that on average, large corporations save $4 for every $1 spent on tax planning activities. There is no research which indicates the extent to which, if at all, the Irish Exchequer is losing out as a result of these tax planning activities of US MNCs. However, the research conducted by Mills et al. (1998) suggests any tax authority should be aware of US MNCs' tax planning endeavours and the potential impact on Exchequer returns. The latter should assist the Irish tax authority (and others) in maximising or at least protecting what is rightfully theirs in terms of Exchequer returns from these companies. Finally, US MNCs are a well recognised and acceptable data base for conducting academic research. Much of the Scholes and Wolfson-based (1992) based research conducted to date, for instance has been based on US companies.

I have chosen to focus on US MNCs in the IT sector, based on initial conversations with contacts in the Irish Department of Finance who perceive this sector as being very significant. There are a number of very large operations in Ireland in this sector. In addition, focussing on one industry facilitates more in-depth interviews. Companies operating in the same industry will frequently face similar business and planning issues which have to be managed from a tax perspective and focussing on one industry in this context should, inter alia, provide insights into the commonalities or otherwise of how and why such companies create, formulate and manage their tax plans.

Having identified the relevant MNCs grouping, I then set about gaining access to and securing interview time with the heads of tax in some companies in this grouping. I successfully obtained interview time with such individuals largely through pursuing two primary sources of contact with these companies. Obtaining access in this way, I believe resulted in a less time consuming process than might normally be the case, particularly when seeking interviews with such tax 'elites' (Odendahl and Shaw, 2001). Firstly, I personally knew individuals who worked in the finance function for such companies based in Ireland,. Secondly I 'luckily' introduced myself at a Tax Research Network Conference to a tax professor based at San Jose State University, who happened to know professionally (and personally in some cases) the head of tax in a number of SV-based IT companies. Both of these 'contacts' were very happy to ask their 'contacts' within the companies to facilitate my research through giving interviews. Resulting from this process, I secured interview time with tax executives in fifteen US MNCs in the IT sector. Table 3.3 presents some background facts on all fifteen companies, covering the nature of their business, turnover, number of employees and so forth. I interviewed 26 tax executives from these companies, many of whom were heading up the tax function in their organisations. The others were all in senior management positions reporting directly to the head of tax. It was very important to interview the 'right' people, namely the ones who could answer the questions posed in the interview schedule. I thought the interviewees chosen were well positioned to do so, and certainly proved to be well equipped to provide the types of insights being sought in this study. In addition to interviewing in-house tax executives, I interviewed three tax advisors to US MNCs. Two of these advisors are senior tax partners with two of the 'Big Four' accountancy practices based in Dublin, Ireland. Due to my own background as a tax manager with one of the Big Four in Dublin, I was well positioned to secure these interviews myself. The third advisor is a SV-based tax advisor to these companies and he is a partner with a large US legal firm. He agreed to the interview when asked by one of my personal contacts (who knew him professionally) as referred to above. I chose to interview these tax advisors as I believed again they were well positioned to give the type of information being sought in this study as they specialise in providing tax advice to US MNCs, many of whom are in the IT sector. The interviews with the advisors were carried out at an earlier stage of the research process (see section 3.6 for more details). Having conducted all of these in-depth interviews I was happy that a point of information saturation had been reached, and further interviews were not necessary for the purpose of this study.

Gaining access to these interviewees, all 'elites' in the tax arena, is, almost unprecedented. These are all in extremely senior positions in their respective organisations with huge demands on their time. Obtaining interview time with such elites would be almost impossible without using personal contacts as described above. It is also extremely important that the interviewer has 'credibility' with the interviewees, which was helped by my having a professional tax background in a Big Four firm.

Table 3-3 Companies' Details

Company Code	Business Description	Headquarters	Year Founded	Auditors	Stock Exchange	No. of employees	No. countries (excl. US)	Turnover ($)
C1	Manufactures computer products and develops software	Cupertino CA	1970s	Big 4	Nasdaq	10,000-15,000	10K*	6,000m-12,000m
C2	Provider of services and equipment for semi-conductor industry	Santa Clara CA	1960s	Big 4	Nasdaq	10,000-15,000	18	6,000m-12,000m
C3	Provides consumers and advertisers with information retrieval products	Oakland CA	1990s	Big 4	Nasdaq	500-1,000	6	Less than 1,000m
C4	Provider of internet Marketplace	San Jose CA	1990s	Big 4	Nasdaq	5,000-10,000	26	3,000m - 5,000m
C5	Technology solutions provider	Palo Alto CA	1930s	Big 4	NYSE	In excess of 75,000	62	30,000m - 80,000m
C6	Semi-conductor manufacturer	Santa Clara CA	1960s	Big 4	Nasdaq	In excess of 75,000	10	30,000m - 80,000m
C7	Manufactures disk drives	San Jose CA	1980s	Big 4	Nasdaq	10,000-15,000	15	3,000m - 5,000m
C8	Developer of network administration and security software	San Jose CA	1990s	Big 4	Nasdaq	1,000-3,000	16	Less than 1,000m
C9	Enterprise software	Redwood CA	1980s	Big 4	Nasdaq	40,000-50,000	58	6,000m-12,000m
C10	Developer of sales and marketing information software	San Mateo CA	1990s	Big 4	Nasdaq	3,000-5,000	31	1,000m-2,000m
C11	Content and network security s/w, it consulting and training	Cupertino CA	1980s	Big 4	Nasdaq	5,000-10,000	30	1,000m-2,000m
C12	Developer of design automation software for integrated circuits etc	Mountain View CA	1980s	Big 4	Nasdaq	3,000-5,000	21	1,000m-2,000m
C13	Manufactures programmable devices and provides design software	San Jose CA	1980s	Big 4	Nasdaq	1,000-3,000	14	1,000m-2,000m
C14	Scientific instruments and vacuum tehnologies	Palo Alto CA	1940s	Big 4	NYSE	3,000-5,000	15	1,000m-2,000m
C15	Man.storage devices and provides storage related software	Scotts Valley, CA, (Cayman Islands based)	1970s	Big 4	NYSE	40,000-50,000	18	6,000m-12,000m

* Only Ireland and Japan listed

3.6 Interview Schedule and Process

3.6.1 The Interview Schedule

As mentioned earlier, the primary data collection method employed in this study was face-to-face semi-structured interviews. There were two phases of interviews. In the first phase, I conducted six 'preliminary' interviews.[135] These first phase interviews which took place in October and November 2004, were carried out in order to, inter alia, establish links with players in the US MNC tax planning arena; help give focus to the research questions; give me an idea of what kind of information such interviewees are willing to divulge; establish what such individuals consider to be critical/of interest to the tax planning business community; to help me decide on what types of questions are most likely to provide answers that will ultimately explain and help understand the practice and process of tax planning; and to assist me in considering possible conceptual frameworks for interpretation of findings from subsequent interviews to be conducted in phase two. These interviews were extremely valuable, the findings from which were pivotal in terms of the future direction of the research. The findings were very rich and therefore I have integrated these findings with the findings from the phase two interviews in Chapters Four to Seven inclusive. Two different interview schedules were used by me as a guide for these interviews, one for the in-house tax executives and one for the tax advisors (see appendices 1 and

[135] Two of these took place with 'Big Four' tax advisors (as described above) at their offices in Dublin, and one was a telephone interview with a SV-based tax advisor. One was with an international tax director with a US MNC who was based in SV, but gave me this interview when visiting the Galway site. That interview took place in a meeting room in a Galway hotel. The other two interviews were with Irish-based employees of two US MNCs, each of which had tax responsibilities. Both interviews took place in their offices, one in Dublin and one in Galway.

2). These schedules were drawn up based largely on a review of the tax planning literature and preliminary reading on possible theoretical perspectives. The interviewees were told in advance what the interview would be about in broad terms.

Following these interviews, the process of constructing an interview schedule for the phase two interviews (as described below) began. This was a very detailed process consisting of: analysis and consideration of the findings from phase one interviews, revisiting the tax planning literature, and in-depth consideration and development of the potential theoretical underpinnings of this research.[136] The second phase interviews, all with in-house tax executives in US MNCs took place in summer 2005. One of these interviews took place in the company's Dublin office. The other interviews all took place in the interviewees' offices in the SV area. (See section 3.6.2 for more details on the interview process). The final interview schedule was sent via email to all of the interviewees in advance of the interviews. This schedule was informed by many aspects of the tax planning literature, the draft theoretical framework, findings of exploratory interviews and by secondary research conducted on the MNCs participating in the study and on some topical international tax planning areas. Questions contained in the interview schedule revolved around the following themes:

[136] Which ultimately focussed on NIS at that stage. The integration of the tax planning, NIS and endogeneity of law theoretical constructs into a comprehensive theoretical framework as presented in section 3.4 took place after the phase 2 interviews.

- The organisation of the tax planning function within the MNC;
- Tax strategy and its alignment with overall business strategy;
- Outsourcing and use of external advisors;
- Performance measurement of the tax planning function;
- Tax and accounting, from both organisational and technical alignment perspectives;
- Tax risk management;
- Technical approach taken to tax planning within the MNC;
- External influences/actors in the corporate tax arena.

Section nine of the schedule included one 'company-specific' question which was based on company-specific research I had carried out before the interview. In addition to gaining additional insights, asking such a tailored question helped to demonstrate that I had researched the company in advance of the interview. Appendix 3 contains 'my copy' of the interview schedule which included all of the company-specific questions, any my probing questions. Each interviewee received a copy of the questions only (without probes), including his/her company specific question.

3.6.2 The Interview Process

Most interviews were on a one-to-one basis. In a small number of cases two interviewees were present at the one session and in one case three interviewees were present in the one session. All interviews took place in the interviewees' office buildings except one which took place in a hotel meeting room, and one other interview was by telephone (as mentioned previously).[137] The majority of the interviews therefore took place in the SV area which helped to give me a sense geographically as to just how small the SV tax environment actually is. Interview sessions lasted for between 45 minutes and 1 hour and 30 minutes.

Generally, I found the interviewees to be extremely welcoming and open in our conversation, despite clearly being very busy and, as with elites, people for whom time was very precious (Odendahl and Shaw, 2001). Like Horton, Macve and Struyven (2004: p.345), there were a number of times when I was surprised at the 'depth of feeling about the issues that had arisen' in the interviews.[138] They were also very interested to know who else I was interviewing. Upon knowing who else or what other companies were participating in the study, a sense of additional 'legitimacy' appeared to be given to my study by them. The asking of this question in itself, indicated their unending concern with what other tax professionals in SV are doing (see Chapter Seven).[139] Some interviewees sent me emails before or after the interview providing clarification on some point. In one case I was sent a company's mission statement via email.

[137] The telephone interview went very well even though it was a little more difficult to read the interview, resulting in a number of unplanned interruptions and silences. One interview was conducted in the staff canteen, which although not very busy at the time, I found it somewhat distracting. It also gave rise to ultimately unfounded concerns about the quality of the recording.
[138] For example, the view expressed by some that it is only a small number of companies acting irresponsibly that has given rise to all the new costly regulations.
[139] Another academic subsequently described this line of questioning to constitute the interviewees' establishment of my being 'inside the fortress', and they were therefore happy to talk to me.

Interviewees were careful not to disclose any specifics of tax plans, nor did I ask for same. TE 26 (one of the preliminary interviewees) had informed me that tax VPs would happily discuss generalities of tax but not specifics. I respected that and understood the sensitivities around potentially commercially sensitive tax details. Notably, in a small number of cases I interviewed different tax executives from the one organisation (for example a VP and the international tax director). Their responses were very similar. A different perspective from within an organisation, on the research questions posed in this study, would only be gleaned I now suspect from interviewing executives outside of the day-to-day running of the tax function.

My professional tax background was a real advantage when conducting the interviews. It meant I was familiar with many of the technical tax terms which invariably came into the conversations, such as permanent establishment, transfer pricing etc (see section 1.3). It also gave me a certain credibility in the eyes of the interviewees.[140] In my current and prior work experiences I have conducted many different types of interviews and this, combined with my technical tax background enabled me to quickly develop a friendly and professional rapport with the interviewees, and employ the necessary investigative skills 'to draw people out and....ward off premature closure' (Miles and Huberman, 1994: p.38). I was also mindful not to be 'passive' (so I nodded, and smiled for example, where appropriate) which can be unsettling for interviewees (Silverman, 1993: p.96).

[140] I had forwarded a brief curriculum vitae in advance of the interviews and a number of them referred to my tax background in the interview. I also sent them a one page executive summary of my research project in advance (see Appendix 4).

I drew on my probes throughout the interview (see Appendix 3), 'as aids to help the interviewer flesh out the question, as prompts for items the informant may have overlooked, or as subquestions derived from previous research' (Miles and Huberman, 1994: p.37). Throughout the course of the interviews, patterns emerged and I tended to draw on certain probes more than others, an advantage of using semi-structured interviews. Some probes became more appropriate than others in the context of stories around the main themes of enquiry emerging. Importantly, through this process, 'the validity of responses is to some extent confirmed by their consistency among different interviewees, which enabled a reasonably coherent overall picture to be developed' (Horton et al., 2004: p.348).

All interviewees were reassured about confidentiality and anonymity. One interviewee was particularly concerned about this as his company has just one major and one minor competitor in SV. I asked permission to tape each interview at the very start. All interviewees were happy to be taped and appeared quite at ease being taped. Taping the interviewees was invaluable as it allowed me to probe the responses more deeply, not having to worry about taking notes. Also, as noted by (Bucher, Fritz et al., 1956), one cannot rely on notes and recollection of interviews. While all of the interviewees followed a similar pattern, some interviews did have a different 'feel' to others. Immediately following each interview, I wrote some notes on the tone of the interview, overall impression formed, and any other observations I had.[141]

3.7 Data Analysis

As noted earlier, interviews were the predominant research method employed in this study. The interview transcripts, post-interview notes and email correspondence received from interviewees before and after the interviews constituted a large amount of qualitative data requiring detailed analysis. Qualitative data analysis involves processes of reduction, classification and interpretation (Lillis, 1999) and the challenge lies in making sense of large volumes of data (Patton, 2002).

The interviews were professionally transcribed. I then listened to all of the interviews and made some minor corrections to the transcripts and incorporated some extra points such as noting an extra emphasis being placed on a particular point by an interviewee. Having researched available coding and computer aided qualitative data analysis (CAQDAS) software, and having discussed the usefulness of such software with some colleagues who had recently used some CAQDAS, I finally decided on using QSR NVivo to assist in data management and to facilitate data interrogation and analysis. CAQDAS is now widely used and recognised within social science and organisational research (Fielding and Lee, 1991) and provides a form of 'audit trail' as well as facilitating data management (Bringer, Halley Johnston et al., 2006). I

[141] For example, some individuals were keen to distinguish his/her company from others in SV using phrases like: 'we are different', 'maybe other companies don't do it this way', 'SOX may have changed things for other companies, but not for us'.

found NVivo to be relatively easy to use and used it primarily as a tool for organising and coding data, although it has other uses including performing text searches and modelling. I was always mindful that coding does not constitute analysis, sometimes an apparent misconception about CAQDAS (Weaver and Atkinson, 1994). As noted by O'Dwyer (2004: p.395), 'CAQDAS is merely a tool designed to assist analysis'. Data analysis was still very much my responsibility as 'the researcher still must ask the questions, interpret the data, decide what to code, and use the computer program to maximise efficiency in these processes' (Bringer et al., 2006: p.248).

Coding, a form of 'ongoing, iterative reflection' (Miles and Huberman, 1994: p.56) is a critical element of qualitative data analysis. Having converted the transcripts and other data (as referred to above) into rich text format, I input the documents into NVivo and subsequently coded all of them. This was largely an iterative process, although I started with a number of codes initially based on the themes addressed in the interview schedule. Upon reading all of the documents again, new codes were created and eliminated as deemed appropriate. The latter is part of a grounded theory approach (Strauss and Corbin, 1990) to the development of coding, although as noted by Bringer et al. (2006), CAQDAS, including NVivo is not dominated by grounded theorists. In totality, the codes are, as noted by Anderson-Gough (2004), 'a mix of things that the researchers are interested in prior to actually starting the interviews and things that become salient as the interviews are undertaken and the transcripts read' (p.375). The latter she posits is 'standard practice'. I carried out a final check on all documents to make sure that all lines in all the documents were coded. A number of lines/paragraphs were coded simultaneously under a number of different codes as at this stage it was unclear where best some lines belonged. The coding process was very time consuming, and took place through immersion in the data, allowing themes to emerge without much concern for the theoretical constructs. I was very focussed on allowing the story of the data in its 'raw' state to emerge. The task of drawing theoretical inferences was for later. The codes (consisting of principal codes and 'subcodes' in some cases)[142] developed are presented in Appendix 5. I did not consider it necessary to use abbreviated terms as is sometimes done.

Following the coding process, I created NVivo Coding Reports (for principal and subcodes), and saved these as Word documents. I then read and re-read these word documents and started the process of extracting the richest and most appropriate quotations, bearing in mind at all times the four research questions posed in this study. This was followed by further analysis of those quotations, drawing theoretical inferences, resulting in predominant themes which became the platform from which the structure and presentation of the findings' chapters evolved (Chapters Four to Seven inclusive).

3.8 Limitations

There are a number of limitations to this study which are acknowledged in this section.

[142] Referred to as nodes and child nodes respectively in NVivo parlance.

The qualitative approach adopted in this study, involving interviews with tax executives from fifteen companies means the findings are not statistically generalisable. To achieve the latter however was not my objective. Rather, it was, to explain and enhance our understanding of tax planning in practice, and as noted in section 3.3.1 to form the basis for theoretical development, which it does. (See Chapters Four to Seven inclusive for many instances of the richness of the theoretical framework developed and drawn upon in this study when interpreting the findings).

All of the MNCs involved in this study (apart from the tax advisors) are based in SV, California. It is arguably a unique place with a physical concentration of IT companies. It is possible therefore that some of the findings are very particular to SV-based companies, although I feel it is unlikely.

For the most part, this study sought the perspective of in-house tax executives and as such provides only one perspective. It could be argued for example that obtaining the perspective of non-tax in-house executives in relation to the embeddedness of the tax function in an organisation, or the perspective of the legislators on corporate tax lobbying, would provide a more complete story and enhance our understanding of tax planning in practice even more. The latter has been included among the recommendations for further study (section 8.4).

As with any qualitative research a limitation arises from the necessary judgement and subjectivity in the analysis of the findings. As noted in section 3.3.1 however, subjectivity is not at the expense of rigour in this study (see section 3.7 also on data analysis).

3.9 Summary

In addition to presenting this study's four research questions and their associated objectives, this chapter has described and explained key aspects of the overall approach taken to this study. The interpretive approach adopted was discussed in detail, and placed in the context of other approaches to tax research. The suitability of the primary research method chosen (face-to-face interviews) was presented, as was the construction of the interview schedule itself and various aspects of the interview process. The study's theoretical framework was presented in two stages: a descriptive framework of the tax arena and core theoretical constructs from the three strands of literature: tax planning, NIS and endogeneity of law, which are uniquely integrated in this study. This framework will be drawn upon in the context of interpreting the findings of this study (see Chapters Four to Seven inclusive). Selection of companies and interviewees, data analysis and limitations of the study were also addressed.

The next four chapters present and interpret the findings of this study, drawing on the theoretical framework presented in this chapter, all of which serve to enhance our understanding of tax planning in practice.

4 Tax: Organisation and Strategic Fit

4.1 Introduction

This chapter presents and analyses the findings in relation to the first research question. Research Question One states: *How is the tax planning function organised and conducted in MNCs?* (see section 3.2 for associated objectives). As noted in section 1.3, while this study is predominantly concerned with tax planning in MNCs, I recognise that the work of tax executives involves both compliance and planning type work. As this section provides information on the organisation of the tax function in the MNCs, it necessarily incorporates some reference to tax compliance also. Some distinct themes emerged within the findings which are reflected in the structure of this section. Section 4.2 provides the necessary background information on the make-up (profile) of the various tax departments. Section 4.3 addresses the issue of resources given (or not) to in-house tax departments. Section 4.4 looks at the internal and external customers of an in-house tax department which incorporates the internal marketing of tax. Section 4.5 examines the interplay between tax and accounting from both technical and personnel perspectives, while section 4.6 presents the findings on various aspects of tax strategy and its alignment with business strategy.

4.2 Profile of In-House Tax Department

The profiles of the tax departments of the companies that participated in this study are quite diverse in terms of number of personnel, and their location as summarised in

Table 4-1. These details were provided during the course of the interviews, and due to the structure of the interviews, some interviewees provided more details than others, resulting in a less than complete picture of all of the tax departments. These facts provide however, an important context within which to explore and understand the workings of the various in-house tax departments.

Table 4-1 Profiles of Tax Department

Company	No. Tax Employees	US-Based	Non-US Based
Company 1	17	17	
Company 2		2+ ?	3
Company 3	1		
Company 4	11	?	?
Company 5	135	< 68	>68
Company 6	c. 160	110	50
Company 7	3	3	
Company 8	2	2	
Company 9	57	?	?
Company 10	9	8	1
Company 11	40	33	7
Company 12	19	18	1
Company 13	10	8	2
Company 14	4	4	0
Company 15	14	13	1

The number of tax employees as represented in Table 4.1 refers to employees who work *exclusively* in the tax department. Interestingly, while these companies are all MNCs trading internationally with a number of foreign operations, with the exception of companies Five and Six, the tax personnel are substantially physically located in the US. For the most part, these employees are all involved in tax planning and compliance work. Exceptionally, Company One has some staff engaged in compliance work only.

Many of the companies also have some non-tax specific personnel based in foreign operations, typically a 'finance' person, 'managing a compliance process as distinct from necessarily having a material role in the decision making as to what is going on' (Advisor 1).[143] Based on the above facts and other findings presented in this chapter, tax planning in these companies tends to be US-centric, where the tone is set and the real tax planning decisions are made: 'the fundamental tax decisions are made in the US' (TE 25)[144] and is thereby 'centralised' (TE 12). The tax executives interviewed were almost all heading up the worldwide, US, or international tax function in their respective organisations from the US, and the three tax advisors were partners in large tax advisory firms with a US MNC client base. Therefore, I am very confident that I interviewed the 'right people' for this study, people who have a great knowledge about the practice and process of tax planning within these MNCs. Notably, three of the interviewees hold senior VP positions, which according to Advisor Three is very unusual for tax executives. The higher the level/position held in an organisation by the head of tax, the more embedded the tax function is likely to be (see section 4.6.3), whereby one's position and status is a source of 'power' within the organisation. Job titles held by the tax executives included: Senior Director of Taxes, VP Tax and

[143] As noted in Chapter Three, in addition to interviewing in-house tax executives in MNCs, I interviewed three tax advisors to such companies, hereafter denoted as Advisor One, Advisor Two and Advisor Three.
[144] TE denotes in-house tax executive. Both male and female tax executives were interviewed. However to protect anonymity, all of the interviewees are referred to as he/his/him etc. as the context requires.

Trade, VP Tax, VP Tax, Licensing and Customs, International Tax Director, Director, US International Tax and Audits, and Senior VP Taxation. The minor variations in title reflect I expect different organisational structures and cultures. As can be seen from some titles, a number of the interviewees are responsible for more than tax, which may be of some significance in the context of making tax important within an organisation (see section 4.6.3).

Another source of 'power' for tax stems from reporting lines. In most of these companies, the head of tax reports *directly* to the CFO, and this was seen as important. In one company, the VP Tax reports to the VP Finance who in turn reports to the CFO. In another company the tax director reports to the VP Accounting who importantly was the tax director previously (which means he is sympathetic to and supportive of the tax function). TE 8 emphasised the importance of having non-US-based tax employees reporting directly to the head of tax based in US. He argued that having them report locally does not always serve to encourage them or indeed reward them for coming up with tax solutions outside of their own country or region (for example, Europe). He similarly accuses tax advisors of the same parochial type thinking. One company has 'a very strong dotted or matrix' (TE 11) reporting line between the international tax managers who are located outside of the US and the International Tax Director. Arguably, from a country manager's perspective, having a direct or 'dotted' reporting line to the US elevates his/her status within the organisation also.

The tax personnel working in these companies are mostly accountants or lawyers, having trained with and worked for one of the Big Four accountancy practices or a large legal practice. In addition, some tax executives are Masters in Tax or MBA degree holders. Therefore, they constitute potentially a group of knowledge experts, likeminded individuals who understand each others' perspectives, are similarly trained and may know each other from prior work experience. They have thereby (perhaps unintentionally) sown the seeds of a terrain for the social construction of reality within the broader tax domain (Berger and Luckmann, 1966), providing sources of normative isomorphism (DiMaggio and Powell, 1991b).

Some of the interviewees have been employees of their respective organisations for a very long period of time and TE 2 recognised the value of the knowledge of the business and structures which himself and his boss built up over the years:[145] 'Something that most companies don't value enough is institutional knowledge. It's not something that you can replace. You either have it or you don't'. Such 'institutional knowledge', coupled with long-term internal business relationships provides a rich internal source of 'power' which helps the profile of tax within any company.

Company Seven which only has three in-house tax executives engages two ex-Big Four Certified Public Accountants (CPAs) for two-three days per week. These CPAs also work for other companies in SV. They are aware of, and indeed contribute to, how things are done in other companies (mimetic isomorphism) from a tax

[145] One tax executive for example was with his company over 18 years.

perspective, and effectively act as a mechanism through which information is shared between organisations. These are 'very smart guys...very knowledgeable' (**TE 13**).

There is evidence to suggest that some companies engage in strategic hiring of certain individuals. Some of the larger companies have employed ex-IRS and state officials. In some cases they were simply the best applicants, in others they were targeted strategically to 'orchestrate the company's efforts' and manage impressions externally (Covaleski et al., 2005): 'they had the relationships that were needed' (TE 6),[146] and the companies certainly do value and use these relationships. In the context of IRS officials moving to tax practice, as opposed to industry, **TE 14** sees them being hired:

> ...because of their ability to get things done. They have channels inside of the IRS but they also know the inner workings, what is it that makes the IRS click? What is it that makes the IRS do what they do?

Similarly **TE 15** referred to the hiring of their two ex-IRS economists, to bring the perspective of the 'other side' and importantly 'they'll fight them when they step out of line...and they step out of line a lot'. Also, hiring economists could reflect what Meyer and Rowan (1991) refer to as '[t]he rise of professionalised economics...econometric analyses help legitimate the organization's plans in the eyes of investors, customers...and internal participants' (p.51).

[146] The implications for the IRS from losing such personnel warrants further examination but is not relevant for this study.

The bringing in of certain types of expertise to a corporate tax department could be seen as part of the legitimating exercise in itself. For example, Company Nine, through having economists on board, apart from them truly adding value, could be perceived as adding value as it is assumed that this company acts rationally when deals/transactions are analysed by economists (Meyer and Rowan, 1991: p.51). TE 13 held the view that the value an ex-Revenue official has in terms of connections in the IRS does have a limited life, probably three to four years. However, in business (particularly in the IT sector), this could be a long time and a lot of value could be added by having an ex-Revenue official in an MNC's tax staff. Some of these officials were creators of the laws which they are now abiding by, which is extremely important in the context of recognising tax law making as an endogenous process (see section 2.3.4 and Chapter Seven). Byrnes and Lavelle (2003) refer to companies building 'powerhouse tax departments staffed with former government tax experts'. Not all companies are interested in this type of hiring practice however. 'I haven't found one yet that I would want to have in my organisation. There are certain characteristics and traits that I look for in people and I don't see them in the IRS' (**TE 24**).

The individual in the above quote does not have any lawyers on his tax team and gave the impression that this was deliberate. Somewhat surprisingly, **TE 15** who has not hired ex-IRS officials, said they 'tend not to be the ones who did the best in school... it's not normal just to go out and hire those kind of people'. Whatever the academic credentials of these officials, the reasons they are hired as evidenced here, are more to do with relationships and their understandings of the workings of the IRS. Another building block of the 'powerhouse tax department' is the tax practitioner: 'The most remarkable recent trend is the fact that they are taking partners in-house to really build up technical capabilities in the larger companies' (**Advisor 3**).

This trend clearly has implications also for the tax and legal practices. One of the tax advisors (himself a partner), did however believe that only those without partner potential would move into industry, unless:

> The range of issues would be perhaps as diverse as the range of issues that they might come across in practice and the challenge as a consequence would be as big and the reward possibly could be as big. Depending on the nature of the company, you could have bigger hitters going in at that level I think. But again bigger hitters would go into bigger teams I suspect. (**Advisor 1**)

Notwithstanding divergent views as to the value of strategic hires, there was a consensus about what type of people are looked for to join in-house tax departments, with a strong preference for individuals with both practice and industry experience. Specifically they look for: 'experienced people, somebody who has already had a background in industry and were public accounting' (**TE 26**). They may also seek:

> ...the very best candidate. We don't care what colour they are...I like people with either a Big Four or a law firm experience <u>and</u> corporate experience...someone that's grounded in the practical basis but knows your SAP system has to work and your accounting group has to book it and those kinds of things. (**TE 10**)[147]

Similarly, **TE 15** referred to 'walking the line between someone who has the very technical background versus people who have good industry experience.'[148] There

[147] SAP is accounting software.
[148] Levine and Lerner (2003) refer to the tax executive needing to be able to combine technical competence with understanding corporate goals etc, as does Wilson (1995).

was a strongly held view that without the corporate experience, 'they don't understand how real companies work' (**TE 10**). The implication here clearly was that accountants/lawyers with practice experience only, often have wonderful ideas (in theory) that are simply not executable in a particular organisation or industry:

> People from accounting, and law firms also tend not to be concerned on, you know, how it ultimately ends up. They want to just sit there, you know, with pie in the sky and come up with a great idea and they're not really interested in seeing how it ends up being ultimately worked through the chain. (**TE 10**)

I think there is something of a 'chicken and egg' situation here. **TE 15** believed it takes about four years for a certified public accountant (CPA) to be 'integrated into industry', so it may be somewhat unfair therefore to be very critical of the CPA's lack of industry perspective.

One interviewee, although as qualified as the others, emphasised adding value through his general management and people management skills:[149]

> I thought I'd be a better manager because I'm good at handling people. I'm good at handling strategy, I'm a strategic thinker, I'm someone that really belongs more in the business set but I have tax, some tax knowledge, right? So, after I got out, I went into industry, that's where I developed my skills well. (**TE 24**)

While it was recognised that boardrooms are becoming more tax aware than ever, in this post-SOX era, rather significantly, no interviewee was aware of any company with a tax director on the Board.

The size of an in-house tax department (in terms of staff and other resources) is dependent on both internal and external factors, but size and complexity of the company and the amount of resources a company is willing to put into tax, and the

[149] As advocated by Wilson (1995).

increasing demands on tax departments arising from the changing regulatory environment, were the recurring determinants referred to by the interviewees. **TE 14** (one of two tax employees in his company) was hired because the company:

> Had crossed through the two hundred to three hundred million dollars and they were beginning to get complex enough that their accountants were saying, you know if you don't bring in help it's going to become more expensive and you are going to be missing things, you don't want to rely on Ernst & Young or whomever to be managing the tax function.

TE 19 attributed, in part, its recent increase in tax staff to a move towards pulling more compliance in-house. The issue of resourcing the tax function was quite contentious among the interviewees and is dealt with separately in section 4.3.

Overall, there are significant commonalities in the make-up of the MNCs' tax departments. Most of the personnel are CPAs or lawyers, who qualified with either a Big Four accountancy practice or a large legal firm, and have a combination of work experience in practice and industry (the IT sector specifically). Professional qualifications and general work experience in themselves therefore are unlikely sources of heterogeneity (Powell, 1991) within the tax planning arena but represent powerful sources of normative isomorphism (DiMaggio and Powell, 1991b). In response to many calls in the literature (for example Perrow, 1985; Dillard et al., 2004), this study addresses the role of 'power' within NIS. For tax to be taken seriously within these MNCs, the function itself and even more importantly, the head of tax must be, and be seen to be 'powerful'. Some clear sources of such power are evident from these findings: the title held by the head of tax (the more prestigious the better); reporting lines (directly to the CFO in US is most powerful); length of time working in the one company (builds up 'institutional knowledge'); raw tax knowledge and expertise gained through qualifications and experience (the tax 'knowledge experts'). The importance of combining tax knowledge with effective communication and people management skills as advocated by Wilson (1995) is also supported. There is some evidence to suggest the building of 'tax powerhouse departments' (Byrnes and Lavelle, 2003) through the strategic recruitment of ex-IRS officials and ex-partners from accounting and law practices, with the latter in particular being well positioned to 'orchestrate the company's efforts' in the endogenous process of tax law making (Suchman and Edelman, 1996 etc.), and manage impressions externally (Covaleski et al., 2005).

4.3 Resources

Many interviewees believed that if they had more resources they could do things to reduce the ETR or cash rate, to avail of opportunities to create more value for the company, and do a better job of keeping up to date with changes and anticipated changes in tax legislation around the world. With regard to the latter, they would prefer to have more local tax personnel situated in some countries (outside of the US and Europe) in the belief that 'it's best to have a local person who lives and breathes it all the time to be able to effectively analyse what should be done over there and to melt it into the worldwide tax.' (TE 3)

However, when asked about the resources being given to the tax function, and particularly tax planning, interviewees' responses revolved around staffing and finance, with a distinct split between those who very happy with their resources and those who were very unhappy. These findings, inter alia, address the reasons (drivers) as perceived by the interviewees for the adequate or under-resourcing of the tax function.

The influence of the CFO (to whom the head of tax usually reports directly) was evident when it comes to providing resources, particularly for tax planning. 'Is he willing to provide more resources to reduce the rate through some more aggressive planning, no?' (TE 3). TE 7 who spoke of looking for more headcount, complained of his department head being 'somewhat passive and likes to present good news', the implication clearly being that needing more tax staff was somehow perceived as a bad thing. Notably, that company has gone from 200 employees to 9,000 in 6 years, with an almost static tax headcount.

Interviewees who were unhappy with the level of resources within their respective departments described their tax departments as 'leanly staffed' and 'running on empty' for a long time (TE 2), and the issue of headcount as an 'ongoing battle' (TE 20). TE 2 did allude to additional staff about to come on board but he was not overly excited however about the level of staff coming in, saying they could really 'use more people that are able to do thorough research, thorough planning, instead of having to outsource' as advocated by Porter (1999a). He would prefer to have an initial attempt at it in-house first, and send a memo to the advisor for external validation. This would, he believes:

> Save a lot of money because we're not having them get some associate working for twenty hours, we are just cutting to the chase saying here is the issue, here is what we researched, please validate yes or no. So it's a very cost efficient way of doing it. We could definitely use more resources within the department to do that kind of work. (TE 2)

TE 2 argued that the need for adequate resourcing of the tax department is the biggest challenge he is facing. His argument articulates very well the potential impact of fast changing business and regulatory environments ('external shocks') on the tax department:[150]

> I am reaching a point where I feel that there is a high likelihood of making a mistake somewhere along the way because the risk is getting greater...and I think it is because the businesses are so quick to market, so there is not a lot of time to react to different initiatives and then there is also your core work, addressing IRS audits, doing compliance. So I just feel...the biggest challenge is just making sure that there is proper coverage because all of those things are important. Not one of them is more important than the other although one will probably get you in jail faster. But you have to be able to go to bed at night, feeling that it's all been properly looked at or considered and that is I think my biggest concern right now. (TE 2)

Similarly, another interviewee referred to the department's shortage of resources being explained in part by the recent acquisition mode of the company, which has kept them very busy, sometimes foregoing tax planning opportunities (not necessarily relating to the acquisitions):

> We just didn't have the resources within our tax group to take advantage of it or even understanding what the resource needs might be outside of our tax group to be able to put other folks and other departments through that sort of a process. (TE 20)

However the need for increased resources in the tax function due to the increasingly demanding external regulatory requirements being placed on these companies should not be underestimated (see section 1.3 also), resulting in perhaps the tax function potentially becoming more compliance driven than planning driven. Advisor 1

[150] Shocks (like these and including mergers and acquisitions) require responses which may lead to changes in institutions as per NIS. This also recognises Wilson's (1995) external terrain and the need to operate within it.

referred to this also, which would have implications for the nature of tax services being offered by tax advisors to these firms.

The technology sector in which these companies are operating are changing very quickly in terms of technologies, geographies, mergers and acquisitions, and ways of doing business, all of which gives rise to new tax obligations and opportunities.[151] TE 2 referred to the 'learning curve' that comes with new opportunities which he believes need 'time, and people don't have time and so if you are not properly staffed or resourced you will never benefit, truly I believe, from those opportunities that are given to you'.

Poorly resourced tax departments (from the interviewees' perspective) can also be explained by the underlying overall financial state of the company vis-à-vis its tax position. Some companies have significant net operating losses (NOLs) for tax purposes, which means that investing in tax planning activities (through increased resources) will serve only to increase NOLs, as opposed to save tax dollars. It is not therefore, easy for the head of tax in this type of organisation to justify an increase in resources, which is frustrating. Interestingly, in one case, despite having NOLs, the company decided (according to the interviewee) to appoint a VP Tax (the interviewee in this case), but then proceeded to starve him of resources. Was it the case that being seen to have a VP Tax in place in itself is important, and if so to whom? Is it

[151] For example some of these companies have recently entered the retail market for the first time. Selling direct to the consumer whether through a retail shop or the internet means there are new tax implications to be examined and managed.

effectively a symbol of legitimacy (Scott, 2001)? Having significant NOLs has also some implications for tax risk management which is addressed in Chapter Six. Other tax departments are under-resourced as 'there is a focus on admin cost containment' (TE 23). Does the latter suggest that tax is perceived in some organisations as an administrative overhead rather than a pursuit with value-adding potential?

A small number of interviewees (generally from the larger companies) were quite happy with their current level of resources. TE 8 stated they are 'excellently resourced...and what we don't have in people we make up in consulting dollars'. Notwithstanding this, he did say that at times they are not always working on the highest and best priorities because they don't have the resources to do so. One interviewee spoke rather proudly of recent down-sizing that took place in his department, advocating his belief in quality over quantity. 'We've upgraded the quality of the organisation, the people and the kind of characteristics, the team work, the kinds of things that help leverage your resources' (TE 24). Interestingly, another interviewee happy with the level of resources given to tax, links the resource level with the successful performance of tax (measured by the ETR) and provides evidence of a powerful player in action (Perrow, 1985):

> As much as you don't like the tax rate as being the sole test but if the tax rate is going down and if tax is looking good and you know the company sees objective results I think [Sr. VP Tax] is getting resources and will be able to continue to get resources in this environment. (TE 17)

The different levels of resources available to the tax departments in these MNCs are driven by such factors as the power of the head of tax and the overall financial position of the company and are evidence of a source of heterogeneity (Powell, 1991). Accordingly, this helps explain some differences between these companies in terms of the practice and process of their respective tax planning activities. Securing adequate resources is an ongoing challenge in light of tax needing to, and being best positioned to, respond to the ever-changing external business and regulatory terrain (Wilson, 1995; Porter, 1999b). This frequently provides sources of external shocks which ultimately may result in deinstitutionalisation and reinstitutionalisation of tax planning practices and processes. Resources themselves, for example having a VP Tax in place, regardless of the exact nature of his/her activities or real power vested in him/her, can facilitate the company being seen to take tax seriously, and thereby act as symbols of legitimacy (Scott, 2001).

4.4 Customers of In-House Tax Departments

Interviewees were asked who they perceived as internal and external customers. There certainly was some consensus on who the internal customers are, although as was noted, 'customers is always a hard word in tax' (TE 9).[152] TE 19 thought customer was an 'interesting' word particularly when he spoke of their relationship with their accounting department which she described as 'a very close relationship and interdependency' (see section 4.7). Many companies prioritised the operations groups, sometimes referred to as business units (BUs) as being a very important and

[152] Taxpayers are also referred to as customers now by the state in many countries which can be contentious. See Lamb, Tuck & Hoskin (2003) and Tuck (2004).

sometimes the most important internal customer (see section 4.6.1 which captures the interviewees' perspectives on the BUs as customers when addressing the strategic alignment of tax).

Other customers identified by many interviewees include the CFO; country directors; payroll; stock services; financial reporting; human resources; the rest of the finance group; the executive office/management team; sales personnel (reviewing contract customer contracts etc); legal department; treasury; business development group (responsible in one company for acquisition and licensing activity); the technology and manufacturing group (specific to one company in which this group determines plant location and expansion decisions and tax feeds into the cost analysis).

Interpersonal skills were highlighted as being critical to the success of dealing with these internal customers who sometimes may not know they are customers until someone from the tax department approaches them and says 'if you use tax as a resource here is what I can do for you' (TE 14). In this context interviewees spoke very emphatically about the need to internally sell tax and educate others within the organisation about the value add capability of tax. Indeed, this matter became a recurrent theme throughout the interviews. For TE 25, how the tax function 'advertises its successes and how it sells itself' is one of the greatest challenges facing tax departments in MNCs. In stark contrast, notably only one interviewee was so happy with the ongoing strategic positioning of tax in its organisation that education and selling was not an issue: 'Don't need to do any selling at all here' (TE 24).

Some tax executives focus on the need to educate senior management around ETRs: 'they really don't understand how it all inter connects', even though they have been warned many times that it will fluctuate due to 'a lot of things outside of your personal control' (TE 3). TE 14 sees it as incumbent upon the Tax Director to educate management on why its ETR is different to other companies in the sector. TE 7 spoke of the need to constantly remind non-tax executives of the tax benefits of their tax structure as tax is not 'foremost on the executive staff's mind'. Rather proudly, TE 5 referred to presentations he gave to the European staff who were 'inherently sceptical' but subsequently were quite surprised when shown the dollars and cents impact of some tax planning. TE 26 referred to his department having educated senior staff on tax risks and costs of business decisions but it does tend to be on a reactionary basis in response to particular developments that present tax concerns. TE 19 did a series of web discussions and presentations around the tax function, the impact of the rate and 'what the drivers are to continue and sustain what we have'. Following a recent significant acquisition 'we have got a whole bunch of education we need to do'. A big one-off event therefore may well present a good opportunity for re-educating the whole organisation and getting the tax function noticed.

Education by the tax department of new staff in the BUs was identified as critical for reasons specific to the .com boom/bust era:

> For us it's a constant re-education process of every new person that comes in to a business unit because they're usually coming from a small failed dot.com where they've been a VP — and I'm sure you've heard this one before you know with their Harvard MBA and they had two plus years in the defunct company and then they come here and they're very used to going by the seat of their pants and we don't function that way. So it is our job to educate and evangelize for the tax department in the different business units. (TE 7)

There would appear to be a greater need to educate the non-US personnel, the 'foreign folks' (TE 6). Physically visiting these people was acknowledged as being highly effective and important in the context of 'building relationships' (TE 21).

A number of mechanisms are in place through which the internal education process takes place. Company Two has weekly *'staffies'* where the controllers and VP Tax meet to discuss ongoing and developing issues. Importantly, this VP finds his involvement with the *trade group* (he is VP, Tax and Trade) a good selling and educating opportunity. Some companies' tax departments conduct *roadshows* visiting all locations outside of the US outlining the work of the tax department: what information is needed for tax purposes; country-specific tax issues; how they fit in with the overall tax structure; how tax fits in with the business world generally (Company Four). TE 23 visits sites based on his availability and needs to 'talk to them about what are current developments, what are new issues they have to be prepared for, what are planning opportunities'. TE 25 presents formally from time to time at sales meetings, but recently has experienced difficulty getting 'revenue recognition' on the agenda as the attendees wondered 'well do we really need to understand this'. Company Five have dedicated business *tax contact people* to spread the tax word to the business. As it measures the performance of 'the businesses' on a post-tax basis, it is also very much in the BUs' own interest to educate themselves on what tax can do for them, although they still need to be educated and 'controlled' by the tax department. (See section 5.4 for a detailed discussion on post-tax performance measurement.)

Only a limited number of responses dealt with external customers. This could be partly explained by the fact that I tended to ask about internal and external customers in the one question. Arguably however, most of the interviewees do not perceive themselves as having external customers or at least they are not as important (or as clearly defined) as the internal ones. 'I don't know that we have any external customers' (TE 24). Three interviewees (from Companies Six, Eight and Eleven) did however state that ultimately the shareholders are their customers also.

Based on the range of internal customers which tax has, it is quite clear that tax crosses a lot of operational matters in any company which clearly presents great challenges and opportunities for tax executives. Interpersonal and communication skills (Wilson, 1995) are of major importance to facilitate tax executives serving their internal customers well. External customers do not appear to be top of the tax executive's agenda which must cause some concern from a shareholder perspective.

Contrary to PWC's (2001) recommendations, for the most part there are limited formal regular presentations made by tax personnel to non-tax personnel. There would appear therefore to be missed opportunities for the in-house tax executive to educate non-tax personnel on the value add capability of tax (Levine and Lerner, 1993). Importantly, however there is some evidence that supports the need for education around ETRs which is driven ultimately by the need to achieve legitimacy (Scott, 2001) in the eyes of various external constituents (Carruthers, 1995).

4.5 Tax and Accounting

This section presents the findings firstly in relation to the interplay between tax and accounting personnel, and secondly in relation to the technical interaction between tax and accounting, with a particular emphasis on the extent to which financial reporting impacts, if at all, on tax planning.

4.5.1 Interplay between Tax and Accounting Personnel

Due to the significant relationship between these two disciplines and their interconnectedness technically, the nature of the relationship between the personnel in both functions warrants investigation. According to TE 21 90% of tax's inter-company focus would be with accounting personnel. This study examined the nature of the relationship and process of interplay between the two sets of personnel, taking cognisance specifically of the impact of such interplay on the tax function.

There was a general recognition of the need for a good relationship to exist between accounting[153] and tax personnel and many interviewees said it was good although in **TE 3's** case it is somewhat 'ad hoc' and 'sometimes we may not call somebody and they get upset because they weren't called or vice versa'. **TE 15** sees tax and accounting personnel as business partners. **TE 5** described the relationship as a 'symbiotic' one. He has an 'informational' relationship with the head of accounting which is a good communication channel, albeit an informal one. **TE 14** described the

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relationship rather comprehensively and suggests the relationship is not quite an equal one:

> Accounting can live without tax, but tax cannot live without accounting. Accounting must buy into and support tax structures/planning — they must help "enforce" policies and procedures to ensure the company does not do anything contrary to the rules, regulations of the government. Accounting must also book all the tax entries related to tax provisions, taxes paid, and intercompany transactions as a result of tax planning/structuring. Accounting also acts as an advocate for tax strategies — I spend much time making sure accounting understands the benefits of tax strategies so they will help "defend" tax to other departments or VPs.

TE 9 referred to 'natural tensions' in the relationship which seem to be around information and communication issues. Similarly, **TE 15** described a bad interplay:

> You didn't give us that piece of information and you should have. Why didn't you tell us about this material and think you did? You know, it's like we can't go review every number just to see if you changed something guys.

The need for communication to be timely, respectful and focused was a recurring theme:

> ...in getting information and it's not just getting the information but it's the timing of the information. Getting it quickly and understanding it etc, so we can use it. And we understand that when we request information we need to make sure that we're not duplicating requests. That the requests are made in a timely manner such that you know everything's not a fire drill. And that we make sure that we're going to the right people so it doesn't bounce around three organizations. **(TE 22)**

This demonstrates the need for good communication. At one company, tax and accounting meet quarterly, and yet they 'have been criticised for not enough communication' in both directions **(TE 8)**.[154]

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[154] Specific reference was made by interviewees to better communication being needed because of SOX, where US companies are having a lot of disclosures and material weaknesses revolve around tax accounting.

TE 20 spoke of the non-stop co-operation and interaction between tax and accounting as being a relatively recent development facilitated by:

> A combination of things. It's partly some emphasis by upper level management on bringing someone in that can talk to people about some of the soft skills within business like feedback, like mentoring, like coaching, like interaction, just better communication skills...over time I think we have tended to hire those kind of people that fit in to a culture of collaboration and co-operation and communication.

TE 21 works on building relationships with his accounting colleagues, trying to 'massage the notion...that we're all sort of in the same boat here'. In terms of how accounting personnel view tax personnel, he thinks 'they're turning. I think they traditionally see us as a pain in the backside to be honest'.

A recurring area of conflict[155] in the tax/accounting relationship revolves around the need for tax to be concerned with tax on a jurisdiction-by-jurisdiction basis,[156] whereas accounting is only concerned with the overall consolidated position (initially at least). TE 16 referred to tax being concerned with getting the right revenue booked to the right legal entity whereas accounting just want to finalise their accounts (consolidated where earnings per share (EPS) is not a function of where revenue gets booked). **TE 18** alluded to the fact that accounting personnel often see it as one big pot as opposed to the different tax jurisdictions. Rather sadly, he said they sometimes 'fall asleep' when he is explaining this. **TE 20** described an improvement in the tax/accounting relationship in this context:

[155] Represents tension within the organisational level.
[156] Typically an MNC must file a tax return in each separate jurisdiction within which it operates.

> Now they understand the need for us to have good information on an entity-by-entity basis and so they support that and they ask us a lot of questions about what we need and whether they can aggregate and summarise certain information or whether we need it detailed out...There is a certain amount here and there of, it's like, well I really wish they would have done the accounting this way to help us figure out what we are supposed to report on a tax return. But for the most part its pretty effective, it really does work.

TE 3 mentioned that some people in operational finance and management accounting 'couldn't care less' about in what legal entities things get booked. They are only concerned with whether a particular product is profitable on a worldwide basis.

The findings demonstrate some natural tensions and exercises of power (Fligstein, 1991) in operation at the organisational level (Dillard et al., 2004) between tax and accounting personnel. Empathy as well as good communication (Wilson, 1995) would appear to be necessary to ensure a smooth and effective working relationship between tax and accounting personnel. The new processes demanded by the introduction of SOX demonstrates a clear enactment of the dynamics of institutionalisation (Dillard et al., 2004) between the economic, political and organisational levels of analysis. Ultimately, these tensions give rise to internal friction at the organisational level between accounting and tax personnel, which is challenging for both.[157]

4.5.2 Technical Interplay between Tax and Accounting

This section addresses the idea of accounting (financial reporting in this context) as a non-tax cost (Scholes and Wolfson, 1992; Yancey and Cravens, 1998). Here it is

[157] Actors at the organisational level were also involved no doubt in reaching an 'institutionalised' response to SOX requirements, which ultimately resulted in an 'endogenous' process, a matter which is addressed in Chapter Seven.

viewed as a friction, the consideration of which may sometimes result in tax optimisation as opposed to minimisation. The need for tax personnel to understand accounting is also partly driven by US tax returns having a section on book-tax differences.

Most interviewees spoke of the importance of being 'accounting aware' when engaging in tax planning, which in itself supports the idea of financial reporting being a friction within tax planning. **TE 22** spoke of the need to understand 'almost in every instance how are you going to account for this', while **Advisor 3** stated:

> The tax law sits on accounting results as a base. It then deviates in lots of ways. But a good tax advisor has to understand how the accounting rules work because the accounting presentation of the books is a starting line. Unless you could understand how a company got to that starting line, you don't have a very easy job of it to understand how the tax line deviates from the accounting base.

Advisor 2's view was: 'I don't know that it's a hindrance or it's a help...it's a big issue.... and needs to be on their agenda'. (i.e. the agenda of company tax executives). Company Four does this through their 'bridge between tax and normal accounting' (**TE 6**). The 'accounting policy' group and tax keep each other very well informed which ensures that tax executives' actions does not create any accounting issues.

Interestingly, there was not general support for the view that accounting rules were significantly hindering or constraining tax planning activities. **TE 8** summed it up nicely: 'In general it's not a constraint, but there have been times when it has been'. **TE 15** seemed even somewhat philosophical about it, 'there are plenty of places from an accounting standpoint that we are restrained but maybe...I've just accepted those so much over the years they're not even jumping into my mind any longer'. Perhaps certain accounting constraints are viewed by tax executives differently over time as they become accepted and the 'norm'. Current topical ones are talked about and the 'old' constraints become so embedded in the process they are taken-for-granted or somewhat forgotten.

Interviewees really seemed to struggle to provide concrete examples of tax/accounting frictions and some even said they couldn't think of any, which may mean that many of the interviewees don't see many of the tax and accounting differences as problems or hindrances — one just has to work within that framework as they are 'taken for granted'. However, a limited number of interesting examples were given. TE 9 highlighted the existence of *'tax attributes'* such as research and development carry forwards, NOLs, capital losses forward and so on, which are deferred tax assets in the balance sheet. These will be challenged by the auditor, who will want them written off if there is insufficient taxable income (in those jurisdictions) to utilize them. This could be a 'big financial hit' so ironically this company sometimes actually seeks to increase taxable income, not decrease it, so as to avoid such a 'financial hit'. Essentially therefore, this company engages in income-shifting (Scholes and Wolfson, 1992) to deal with this:

> Moving income from one year to another, making sure that we have enough income of the right type, it could be capital gain income, foreign source income, whatever, to use our attributes...even if you don't lose them per se from a pure tax law sense, you can have to write them off on your financial statements because you are carrying these things as assets. (TE 9)

TE 8 referred to an example involving some *withholding tax mechanisms* being considered which would have resulted in debt appearing on the balance sheet. If the treasurer and controller did not want that on the balance sheet (even though it is not real debt) then TE 8 would probably not do that. The treasurer is interested in this because an increase in debt might not be looked on favourably by the rating agencies. Therefore, 'treasury' or '*market impact*' is another friction or non-tax cost/consideration. Relatedly, TE 19 said it is interesting to see the interplay between tax, accounting and treasury, drawing on an example of investing in tax-free bonds and fully taxable bonds which was essentially addressing intrinsic versus extrinsic tax, having an input from treasury on this and getting accounting involved to ensure it works from that perspective also.[158] TE 16 highlighted '*revenue recognition*...where does the title change' as being an area of conflict between tax and accounting. This seems to be quite a significant issue (in that company at least) whereby revenue recognition can never be disrupted even if there is a great tax plan that may for example involve income deferral, but damage may also be done for VAT purposes.

TE 4 referred to a concern in relation to the financial reporting impact of *stock options*. There seems to be some concern about whether or not stock options have to be expensed in the accounts, and the notion of 'cushioning' for such a possibility. TE 11 identified this as an issue for high-tech companies and his company does not believe expensing stock options is good accounting. He said the complexity surrounding this is 'mind-boggling'. This issue seems very current and serious for

[158] Scholes and Wolfson (1992) address implicit and explicit taxes.

some of these companies and it surrounds the valuation of a stock option when it is granted.

Finally, the tax reserve setting process was discussed with the interviewees. Setting tax reserves clearly indicates some question mark exists over the eventual tax liability attaching to some transactions, and my findings certainly demonstrate this process as being quite contentious and essentially amounting to tax risk management. It is considered and discussed therefore in Chapter Seven.

While there was clearly a consensus on the need for tax executives to be accounting aware, there was only limited evidence to suggest that financial reporting is a conflicting interest (Hoffman, 1961) to be resolved when tax planning, or when it is a non-tax cost (Scholes and Wolfson 1992) which constrains tax planning significantly. Arguably, many of the interviewees perceive financial reporting rules as 'taken-for-granted' parameters (institutions) within which tax planning must take place, rather than constraints or conflicts. The tax planning areas around which financial reporting seems to constrain tax planning efforts include revenue recognition, losses carried forward, withholding taxes and stock options. There was some evidence in support of 'income shifting' being utilised to counter any negative financial reporting consequences (Scholes and Wolfson, 1992; Samson, 1998; Fallan et al., 1995).

4.6 Tax and Strategy

As noted previously (see section 2.2.1), very little tax research to date has provided a real understanding of how a strategic role for the tax function is defined, mapped out, implemented, managed and monitored on an ongoing basis in complex ever-changing organisations like the MNCs in this study. Gaining this understanding therefore was a key objective when discussing tax strategy with the interviewees.

4.6.1 Alignment of Tax with Overall Business Strategy

There was general agreement that a tax strategy should not drive the business but on the contrary, 'the business should drive tax and company tax strategies' (TE 14). Similarly, TE 5 believes 'the tax tail shouldn't wag the operational dog'. It was clear that sales drives these companies and that tax strategies should not interfere with sales or the company's ability to sell products. Business decisions are generally made in principle, for example to set up a shared service centre for Europe or EMEA[159] and at that point the in-house tax department becomes involved to find the best tax-based structure that will also deliver on the business decision. Extending this further then it is 'incumbent upon tax to understand management's overall objectives and to develop strategies that are in line with those objectives' (TE 14). In support of this, TE 15 stated 'it doesn't matter how great a tax planning idea you have if that doesn't align with the business interests then there's nothing really of value that we can add'. TE 10 was keen to point out 'we are not an Enron where we view tax as a standalone function that should be creating its own planning and savings, tax is an adjunct to the business'. One interviewee, TE 21, did hold the view that tax can change the way they do business, for example a new or changed tax treaty could lead to a change in the location of a sales operation and save significant money.

[159]EMEA denotes Europe, Middle East and Africa.

When discussing the strategic alignment of tax with the interviewees, important findings emerged with direct relevance to the Scholes and Wolfson (1992) framework. Their framework, employed to date by researchers taking a micro-economic approach to research, was referred to in section 2.2.4. They advocate a strategic approach to tax planning through consideration of all parties, all taxes and all costs and engaging in income shifting, all of which are core elements of their framework.

In relation to considering *all parties* to a transaction, **TE 5** did say that while each party is out for the best position for itself, to cut a deal there may have to be migration towards a compromise and he cited examples where this worked very successfully after some back and forth with the other party. In the end he says 'it comes right down to...it's a business decision, we have got to go with it'. If a deal needs to be done, a satisficing tax position will not get in the way. Clearly companies need to be careful in this negotiation process and be mindful of how much they wish to disclose to the other party about their own overall tax position. **TE 14** referred to instances where he engages with a third party (a strategic alliance partner, customer) and 'hammers out all the issues'. When tax gets involved on one side, it tends to on the other also. **TE 18** provided strong support for the practice of consultation with customers to come up with the optimum solution for both sides:

> We work with our customers to go ahead and try and you know when we look at deals can we go ahead and structure, how can we go and structure the deals so that we can make it go?

Similarly, **TE 23** discussed this in the context of recent acquisitions:

> It's usually friendly because typically the people we are talking to are employee sellers and so they're going to continue and be part of our organization...but they're very focused and their advisors are advising them to maximise their after-tax return and they aren't terribly concerned about maximising our return...but you know, it's brought up in dialogue and sometimes we work towards a middle ground but in most cases we want to do the deal, you know we can already taste it, and that if we have to sacrifice something on the tax side it's sacrificed.

Advisor 1 provided strong support for consideration of *all taxes* arising on a transaction, 'the best tax solutions are ones which are considered on an all tax head, taking everything into account'. However he did go on to explain that a generally tax efficient solution may not work in every situation or for every client due to different circumstances. Tax plans therefore need to be 'personalised' to suit each situation (Hoffman, 1961).[160]

While there are clearly many frictions by way of non-tax costs or considerations that these tax executives have to consider (as referred to earlier in this chapter), issues around operating in non-US jurisdictions appears to be particularly problematic and costly. **TE 12** spoke of significant clashes between tax and the 'business model' in China and Singapore. They wanted just capital and labour to go through China and to centralise raw materials elsewhere. He said China wasn't very happy with this.[161] It appears to have had a significant impact on these operations and **TE 12** said 'to balance that out, you know we have to make some concessions in other places'. In this context of investing in different countries around the world he emphasised the need to maintain positive relationships with different countries. He referred to the fact

[160] I recognise the vested interest of the advisor in this context.
[161] I understood the reference to China here to mean the Revenue Authorities in China.

that some countries get 'jealous' when you move into other countries (even if investment remains in all countries).

TE 15 identified the all-embracing nature of non-tax costs as being whatever way the business has to be run, and what tax comes up with has to be acceptable to the business and to the market. 'We can't have the business behaving in an aberrant way just for tax purposes'. With respect to the latter he added:

> You know, there are certain things that maybe we would like to do from a tax perspective that if it got played out in the market...would not be seen as positive...there's always this balance of you get the best answer that promotes the ability within the company to do our business.

Relatedly, **Advisor 1** spoke at length about a change he sees over the last few years (post-Enron) where companies are no longer just concerned with technical robustness of tax plans but:

> Also from a smell factor perspective of good corporate citizenship...the predominant view would be to minimise global tax charges within the confines of being able to treat or be regarded as meeting their social and corporate governance obligations.

He agreed that this concern about corporate image is tending to decrease the level of tax aggressiveness, although he acknowledges that there will always be people for whom technical robustness is all they care about.

Finally, in support of the activity of *income shifting*, **TE 9** described a lot of the tax planning he is involved with as revolving around 'moving income from one year to another, making sure that we have enough income of the right type, it could be capital gain income, foreign source income, whatever'. This is driven by their concern for the efficient utilisation (from both tax and financial reporting perspectives) of 'tax attributes' such as NOLs and research and development carry forwards.

How do these companies work towards strategic alignment and thereby add value? Reporting lines and the level at which the head of tax operates in the organisation was strongly emphasised in this context:

> A tax person should always report to the CFO, not to anybody else. I get equal time at our Audit Committee. I'm on our Disclosure Committee. I go to the governance meetings. I have to sign off on the 10K, I have to sign off on the Rep letters. You know all of those things, those are all critical because if tax isn't seen at that level, forget it. (TE 15)

This company's tax department recently enjoyed increased visibility throughout the entire organisation through an acquisition project whereby the tax department decreed what could and couldn't happen on a country-by-country basis and those at the highest level had to listen and obey with 'the threat of a $10 billion capital gain across the board' (TE 15).

Processes that involves regular meetings and updates from the BUs were also identified and do take place in these companies. Some companies have quarterly meetings, and others have them less frequently.[162] Company Five rather uniquely enhances strategic alignment by having a single point of contact between the tax department and each line of business. This facilitates what they see as the continuing

[162] For example, Company Twelve has an annual meeting called 'Focus' where the President, CEO, Finance etc, meet and the objectives for the year are set out and discussed. The tax department like all other departments are then expected to ensure its work throughout the year doesn't conflict with these overall business objectives but complements them instead.

need for tax and business to talk to each other.[163] TE 8 spoke of the importance of having a legal structure that is cross-functional and a strong VP for international tax. This interviewee also thought the company deals with international tax issues better than tax advisors as its tax personnel has more cross-border interaction than the advisors do. Specifically, he feels that some European-based tax advisors cannot think of solutions outside of Europe whereas a strong VP for international taxes will look for a solution anywhere in the world. All of these processes/mechanisms facilitate the early consideration of the tax ramifications of any business plan, which would be deemed good practice.

In line with the tax planning literature, there was significant support for the idea that tax should not drive business decisions (Valente, 2002; Yancey and Cravens, 1998; Karayan and Swenson, 2007). The findings suggest that in-house tax executives work towards strategic alignment of tax through, reporting directly to the CFO, having as senior a title as possible in the organisation (the latter two have already been identified in this chapter as internal sources of power for tax), and regular meetings and updates with BUs. All of the latter should enhance the prospect of tax being consulted as early as possible on the time line of any business transaction as advocated by Holzman (1965), James (2005) and Karayan and Swenson (2007).

There is also evidence to support the inclusion of all parties, taxes and non-tax costs (Scholes and Wolfson, 1992; Fallan et al., 1995; Yancey and Cravens, 1998) in any

[163] This works well in this company of course as this idea is inextricably linked with its philosophy of assessing business units on a post-tax basis. (See section 5.4 on performance measurement).

theoretical framework being applied in a quantitative manner. The nature of the non-tax costs may however be very varied over time and across organisations. Application of such a framework therefore may have more meaning when applied to a particular industry only. In this case the nature of the tax issues and non-tax costs are more likely to be homogenous, thereby potentially having more explanatory power. All non-tax costs however are not measurable, which in itself perhaps questions or challenges the use of the word 'costs' which may well conjure up the notion of something that is measurable. If it were measurable, it certainly falls into the realm of economic efficiency, which has been recognised as not necessarily working against the original NIS perspective (Powell, 1991). However, a non-tax cost or friction identified in this study does work perhaps in opposition to the economic efficiency perspective, namely the need for any tax structure to be viewed as 'legitimate' (Scott, 2001) by the local market be it China, Japan and so forth. This was very clearly identified in the context of what tax-based structures are put in place in non-US locations. It is very difficult, if not impossible to measure and capture the latter type of concept in any quantitative model. This friction may motivate a company to pursue a less tax-effective structure but this can only be confirmed from the in-house VP tax as opposed to interpreting publicly available financial data. In this type of situation, the need for legitimacy, a core concept within NIS takes precedence over what Dillard et al. (2004) described as the primary legitimising characteristic of economic efficiency, and thereby explains an organisation's 'rules and organizing logics' of tax planning (DiMaggio and Powell, 1991: p.33).[164] It may also contribute to a change in

[164] See Chapter Seven for more on other non-tax costs.

attitude to tax laws by some company executives, an important factor identified by McBarnet (2001a) (see section 2.2.4).

Having clearly reached agreement on the importance of alignment of tax with business strategy, the next section looks at the actual tax strategy/mission of these companies which needs to, inter alia, facilitate this alignment.

4.6.2 Tax Strategy/Mission

This section deals with the specifics of the various companies' tax strategies. Seven of the fifteen companies involved in the study have a documented tax strategy or tax mission statement. These statements are similar to some extent but vary in length and emphasis. Most of the other companies do not have a formal documented tax strategy in place but may have monthly or quarterly objectives in relation to tax. While those interviewees did not see a real need for a documented strategy they did say that they understand what their own company's tax strategy is. **TE 19** said he is 'more about making sure that it's clear to everybody as opposed to putting a document out there'. Of course, putting a document out there may be one way of making sure that it is clear.

It may be that having a documented tax strategy is more important for bigger companies with bigger tax departments so that 'the department people know what is going on...and it also helps the bigger broader management understand.'(**TE 14**) In smaller companies, with say less than ten tax employees, they are typically in daily communication with each other, the CFO, and in some cases members of the wider company management team. For such smaller companies, a documented tax strategy may not add value. **TE 12's** view was 'it's in so few people's heads it could be construed...that we have a coherent strategy'.

One Director of International Tax (TE 2) referred to his own 'personal mission statement' and was not at all convinced that it would be consistent with the view of the senior Director of Taxes (to whom he reports). Somewhat worryingly he said 'I have never had the discussion with him really...I am not sure we would ever come to agreement'. The same interviewee, when asked about whether they have a documented tax strategy, having said no, admitted to now thinking 'oh God, should we?'

What tax strategies/missions do these companies have in place? Many interviewees described the company's tax strategy in terms of overall goals and objectives. Common goals and objectives filtering through many companies include legally minimising the effective tax rate,[165] looking for opportunities to lower taxes further, tax law compliance worldwide, keeping out of trouble (with Revenue Authorities), and being responsive to internal customers. For example, **TE 5** said his objectives include keeping, 'our effective tax rate below a certain percentage of pre-tax income and...it's certainly to minimise our worldwide tax burden consistent with complying to all laws and regulations'. One large company's senior VP for taxes **(TE 15)** admitted to having a tax mission statement for the company but rather jokingly said 'I

[165] I recognise the term 'legally minimising' is not necessarily a simple one in this context. See literature review (section 2.2.4).

haven't seen it for a long time. It exists somewhere'. In addition to referring to tax compliance, this company's mission statement specifically emphasises optimisation, 'it is never minimisation; it has to be optimisation with acceptable risk'.

Importantly, this mission statement recognises there is some degree of risk taking within tax management. (The detailed findings concerning the importance of recognising, assessing, managing and monitoring tax risk is dealt with in Chapter Seven).

TE 24's tax mission incorporates four distinct elements and distinguishes itself somewhat from others through its emphasis on recognising tax personnel as business partners, 'we are excellent partners who proactively identify tax opportunities, minimise risk and efficiently fulfil regulatory requirements'. TE 10's mission has a strong focus on compliance but since 'the beginning of time' its overriding philosophy is 'cash is king', so from a tax perspective, 'tax just nests right under that, where our goal is to make sure that we save cash. Financial statements are nice but secondary to cash'. This company is very process-driven and sets annual objectives, sets out and deals with 'quarterly hots' (items which they expect to happen in the quarter), and detailed monthly progress reports. The senior tax team also meets every month for a Project Status Review Meeting to deal with and update each other on 'big ticket items' in order to ensure 'everyone's on the same page'. Company Ten, whose strategy incorporates minimising cash taxes, also incorporates maximising EPS which are sometimes in conflict with each other. The CFO becomes involved in deciding which of these strategies wins out in any particular situation.

One company's tax mission clearly incorporates the economic-based objective, seeking international competitive advantage through its tax mission. It does also reflect however the company's desire to foster and encourage a particular type of working environment. It states, 'to give [the company] an international competitive advantage, by minimizing taxes, thereby maximizing worldwide cash and earnings per share. To maintain an energetic working environment, where initiative, creativity, continuing education and knowledge sharing are highly valued'.

For TE 19, 'managing of world wide tax risk and supporting the business in a cost effective manner are two of the key tenets that we hold'. This strategy reflects a 'tactical focus' as the tax department is under-resourced. When the tax department is under-resourced the head of tax quite often has to 'pick and prioritise' what one needs to work on. Accordingly, some tax-based ideas/strategies do not get pursued. In this company the tax department was growing and with recent director and senior manager level recruits about to join the tax department this particular interviewee was looking forward to enhancing the planning side of the in-house tax function.

TE 22's mission statement along with sharing many of the objectives of other companies, specifically alludes to the tax department being a service provider and distinguishes itself somewhat from other mission statements by referring to the means by which it seeks to minimise taxes, in line with Scholes and Wolfson (1992), 'to provide strategic business and tax planning services, decrease the effective tax rate, increase net income in cash and minimise taxes paid by maximising tax deductions and tax credits and tax deferrals.'(TE 22) A very detailed documented tax mission/strategy statement was presented by TE 8 as follows:

Increase shareholder value:

- After tax management reporting[166]
- Attract and develop and retain high quality people who think globally
- Excellent working relationship and credibility with governmental authorities
- Long-term tax rulings and other agreements with governmental authorities
- Develop, acquire and implement integrated tax planning opportunities relevant to [the company's] global tax profile
- High quality in all we do
- Strong relationship with the business and global operations
- Proactive representation of [the company's interests before legislative and regulatory bodies

The eight objectives are prefaced by the overriding objective of seeking to increase shareholder value.[167] Importantly, it seeks to recruit the global thinker, is concerned about its 'relationship' with governmental authorities and significantly and possibly relatedly, it is proactive in its representation before legislative and regulatory bodies. This mission statement is according to the VP for US tax in this company, 'the most

166 Its first strategy is to measure performance throughout the company on a post-tax basis. It is the only company out of the fifteen in this study that does this. This is discussed in more detail in the context of performance measurement – see section 5.4

167 This over-riding concern with shareholder value is also part of Vodafone's Tax Code of Conduct which Vodafone published as part of its 2006 Corporate Social Responsibility statement. (http://www.vodafone.com)

articulated and best crafted one' he has ever seen. It is driven by a 'strong leader' in the Sr. VP for tax who frequently reminds staff of the above objectives. Essentially these things matter 'because he makes them matter'. The latter emphasises the power of this Sr. VP in this organisation (Perrow, 1985 etc.). This tax strategy had obtained Board approval which in itself may indicate an elevated position for tax within this particular company. The Sr. VP stated clearly this company wants to be 'squeaky clean' and has an overall strategy of 'uncompromising integrity'. In relation to tax planning, he spoke very openly about their strategy of developing (coming up with ideas internally), acquiring (buy and steal) and implementing (completed internally and can be a very under-rated function) tax plans.

Some interviewees dealt with this question of strategy in a more narrow sense essentially saying that their overall tax structure constituted their tax strategy. Therefore, once this worldwide or European tax-based structure is in place their responsibility is to ensure tax compliance within the existing legal structure and to monitor the efficiency and appropriateness of the structure on an ongoing basis in light of changing tax laws around the world and changing business needs. In that sense, the term 'tax strategy' was used interchangeably with the term 'tax structure' by some of the interviewees and thereby presents a company's tax strategy as a once-off event (in need of monitoring) for some of these companies.

Some interviewees appeared more comfortable talking about having a tax 'strategy' than others, which might suggest that tax is sometimes perceived as being more tactical (often relating to structures) rather than strategic. For example, TE 7 said their tax strategy was set up in 1999 in order to minimise taxes. This strategy runs into problems when the company acquires a foreign entity which subsequently needs to be moulded into the existing overall corporate tax structure. The importance of the tax structure being 'elastic' and able to 'absorb as many entities as needed' was emphasised by the interviewee (Scholes and Wolfson, 1992) The benefits of this type of worldwide overall tax structure needs to be continually pointed out to country managers and executive staff.[168] Also, for companies with these types of overall tax-based structures, tax plays a significant role in the future operational side of the business. For example, it may preclude setting up an operation in a specific country as the latter may negate some of the existing tax advantages arising from the existing structure. In that sense, tax is to a greater extent playing a pivotal role in the operating of the business. Another somewhat narrow interpretation of what is meant by tax strategy was given by **TE 3** who stated that its 'tax strategizing centres around foreign source income planning so we can capture our foreign tax credits in the foreign locations'.

For a minority of companies the idea of having a formalised tax strategy/mission appeared to be irrelevant. They were not concerned about it and establishing one was not high on their agenda. Surprisingly, one VP (**TE 18**) stated: 'There is a mission statement but I couldn't tell you what it was you know...I haven't updated it'. This individual however had difficulty in getting the CFO to believe the tax function could add value. **TE 26** was of the view that 'strategy-wise there isn't a whole lot of

[168] See section 4.4 for further findings on the area of educating the entire company about the role of tax and the value the tax function can add when involved in various business initiatives.

attention given to actually documenting planning out and I haven't experienced to what merit it is'. This company does identify key projects for the year which gives some strategic direction (tactics?). He did acknowledge however that 'there is the usual departmental mission statement and vision of how you operate...and that's just fairly nice and woolly and contributing to the greater good etc'.

Interestingly, while the tax advisors interviewed said they expected their clients to have tax mission statements in place, they had not seen them and clearly were not consulted for assistance in putting a mission statement together. It would appear therefore that tax mission statements are almost seen as private to the company itself. The advisors were not in any way concerned about the fact that they do not have input or insight into a company's overall tax mission statement. They were happy that they were aware of their clients' viewpoint on tax and their overall risk profile, in one case likening it to motherhood. 'You kind of know what it is but you have never had someone sit you down and preach to you about it'. **(Advisor 1)** This same advisor sees a company's tax strategy being governed by internal policies and 'generally accepted norms within tax planning circles particularly for US multinationals and US-quoted companies'. **Advisor 2** said 'we probably know their micro-objectives more than their macro-objectives' and was quite content with this. **Advisor 3** pointed out that:

> Taxes tend to be the second largest expense of a company after payroll, at least for companies that are profitable and paying tax. The goals of these companies should therefore include remaining competitive with their peer group in terms of their effective tax rate and not providing surprises to the financial markets by having their effective tax rate fluctuate significantly.

There was no consensus as to the merits of having a formalised documented tax strategy in place. Tax strategy was frequently interpreted as meaning tax structure, and some interviewees were less than convinced that having a formalised documented tax strategy would add value. Unsurprisingly, those companies that have strategies firmly documented believe in their importance and role in tax.

The various tax strategies and mission statements in place reflected a mix of quantitative (as per Scholes and Wolfson, 1992; Porter, 1999a) and qualitative goals, which collectively reflect the roles of policeman, service provider and business partner alike to be provided by tax executives (Wilson, 1995). Many of these goals were also indicated as areas of performance on which tax executives are measured (see Chapter Five). There was some evidence of frictions (Scholes and Wolfson, 1992) within a tax strategy, for example where a company aspires to minimising cash taxes while maximising EPS. There was little evidence of corporate tax strategies seeking or obtaining Board approval as advocated by PWC (2001). There was some evidence of decoupling (Meyer and Rowan, 1991) reflected in the fact that some interviewees referred to a tax strategy being in place but rarely if ever referred to it or updated it, (suggesting it amounts to no more than myth and ceremony). The tax advisors' perspectives on corporate tax strategy and goals provides evidence of sources of mimetic isomorphism in their emphasis on remaining competitive and the idea of accepted norms within circles of companies in this context. This goes to explain a degree of homogeneity (DiMaggio and Powell, 1991a) throughout the MNCs in SV with respect to tax strategy.

4.6.3 Importance of Tax in the Company and Tax Embeddedness

The literature provides some mixed findings on how important tax actually is in organisations and on how its level of importance could be improved upon (PWC, 2001 and Porter, 1999a). The main objective here therefore was to establish how important tax is perceived within these companies, how well embedded tax is in the organisations and to establish in particular the extent to which tax executives are consulted and brought in sufficiently early on in transactions. This all helps explain to what extent tax can, and does, play a strategic role in business.

While all interviewees felt tax is important to the company (often subject to some caveats) the findings here demonstrate different degrees of importance and internal supports for tax (Wilson, 1995). The level of tax awareness among non-tax executives (as perceived by the interviewees) was quite mixed throughout the companies. **TE 4** felt strongly that what tax executives do is not appreciated, it is important but 'they (the non-tax executives) don't know it'. However, they did refer to a growth in awareness but only because 'over the last number of years we've raised the profile'. **TE 2** also spoke of a positive change. 'I would have to say that over the last five years we have become much more strategic in our role' (although he did acknowledge that there are still instances when he is consulted after something has happened). This trend towards involvement of tax executives upfront is partly driven by the tax personnel pushing themselves forward over time and becoming as engaged as possible with the business. It is also driven by the fact that these companies are operating in so many different countries so the tax risks are greater:

> I do think that the message is getting loud and clear that tax is a key player and especially as we expand internationally, there is a lot of concern about taxes, there is a lot of concern about the structure that we have and so the groups tend to involve me a lot more early on. (TE 2)

There was general consensus that the earlier on in a business transaction that tax gets involved, the better. As described by TE 24, 'if you're not in on the very beginning you often miss a lot by the time you get to it'. TE 5 did refer to tax planning however as frequently being a case of 'damage control', where tax is consulted far too late in the process.

Is tax important in these companies? Four companies stood out in terms of the very high regard for tax which they perceived as existing within their respective organisations. Perhaps unsurprisingly, three of these were the biggest companies in terms of turnover, number of employees, and number of tax employees. TE 11 spoke of tax being given a great deal of respect in the company both from a 'keeping [the company] legal' standpoint and from having 'a seat at the table before transactions are completed' standpoint. This company's tax function appears to be very visible and the country managers regularly approach them for their tax input. TE 24 attributes its tax function's high degree of integration with the business in part to the fact that his boss is one of the five leading executives in the company and has great admiration for the tax department. The latter again emphasising the importance of having an admirer of tax at a high level within the organisational structure. He lets TE 24 know about things before anybody else 'just in case'. This tax department does not have to 'go begging' to be involved. The latter of course supports the view that the function must be supported from the top down. TE 23 viewed tax as being important to the organisation because 'it's a very material part of our external financial reporting'. **TE 18**, despite having lots of problems internally selling the idea that tax can add value, is of the view that within the organisation tax is seen as very important due to its impact on EPS. It's a 'huge driver' in EPS and is therefore very important.

Other interviewees were not so convinced that the tax function was highly valued in-house. **TE 25** thought it would be viewed as 'being slightly academic and technical and something that happens in the background' and in relation to that company's 'tax structure' he was not convinced that a lot of people in the company understand it, nor that 'the tax people have ever gone out of their way to explain it, it's sort of on a need-to-know basis almost'. Interestingly, this interviewee works in the company's shared service centre (located outside of the US) with some responsibility for EMEA tax compliance, with little opportunity to participate in tax planning. His view does contrast somewhat with that of the Director of Taxes of this company based in the US. This interviewee showed significant frustration at the fact that the sales people did not (in his view) understand and appreciate the tax structure. There is a clear need for the tax department to communicate outwardly also however.

Advisor 2's view on how important tax is within organisations, is that it varies hugely from one company to the next and 'it's probably a cultural thing'. He also spoke of the impact of 'boardroom forces' which can ultimately be driven by 'market forces' reflected in the need to impact on stock price.

There were a number of factors identified as impacting on the importance of tax within an organisation. Firstly, the *CFO* was identified by all interviewees as having a very significant role to play with regard to the level of importance attached to tax within an organisation. Interviewees held some strong views on this which are dealt with separately in section 4.6.4.

Secondly, *the length of time over which the tax personnel, in particular the VP for tax is in place* is an important factor. For example, one VP for tax who has been with the company for eighteen years has 'an institutional history, institutional connections...in the forefront with the senior management' so that 'we sort of are involved, you know, pretty early on in transactions' (TE 15). Relationships between the VP for tax and senior management are vital. This VP is on the Disclosure Committee, goes to governance meetings, signs off on the company's 10K and so forth.

Thirdly, there was some evidence to suggest that it is driven by businesses becoming more *profitable and diverse*. Both of these changes can make senior executives more concerned about tax exposures and about minimising taxes. TE 25 summed this up: 'as the European operation expands and matures and makes more money, I think tax becomes more relevant'. The corollary of this of course which was also evident in the interviews, is that it is often very difficult for tax to be treated as important strategically when a company has significant NOLs. TE 12 actually described its NOLs as a 'safety drop'. Therefore, from a tax planning perspective, even if something goes wrong the company will not be paying taxes for a very long time and the reputation of the tax department is not at stake. It was clear that tax gets noticed and is appreciated much more for reducing ETR significantly than efficiently utilising NOLs.[169] For a company with large NOLs it would appear that investment in tax planning is well down the chain of management's priorities. TE 25 spoke of ongoing tax planning opportunities being limited due to the company's loss making position. **TE 18** agreed: 'people won't pay enough attention to the tax function because it's not a cash out'.

A fourth factor concerns a *major tax event or accomplishment* which brings tax upfront and to the notice of senior executives. Thereafter, tax can often be seen as highly strategic. Company Four managed to significantly drop the ETR from a high of 44% in a short timeframe. Another interviewee secured a very favourable outcome on a potential $140 million tax liability. Even after such events however, tax must continue to lobby itself within the organisation or lose its 'lustre' (TE 7). **TE 17** spoke of the value of having some 'proven accomplishments', related to the Board in terms of reducing cash taxes and ETR.

Fifthly, *resources* available to the tax department are also indicative of the extent to which tax planning is integral to business transactions. Tax planning is sometimes seen 'as a luxury as opposed to a necessity...for most tax departments that are very leanly staffed, tax strategy and tax planning are the first things to go because people are just trying to comply' (TE 2). (See section 4.3 also on resources).

[169] Has implications for performance measurement – see Chapter Five.

A sixth factor identified is the *recent changes in the regulatory environment* generally, which has put tax high on the Boardroom agenda (see Chapter Six on risk management also).

A seventh factor concerns the extent to which *integration processes* are in place within an organisation to facilitate tax interacting with others in the organisation (and thereby becoming integral to business transaction), whether it be the CFO or operations people. A limited number of the companies examined are process driven in this regard. Company Eight has regular meetings with the CFO, VP Controller, financial planning and analysis people and the attorneys (always involved in writing contracts which may need a tax executive's perusal). The bigger companies certainly have regular meetings and for the smaller companies the need to formally set up regular meetings is not necessary as it may be naturally easier to be in regular communication with colleagues across the company. Communication however, is paramount and providing sufficient opportunities on a formal regular basis for interaction might well be good practice and go some way to ensuring that tax is engaged with and on a timely basis.

TE 19 is happy that tax is brought into transactions at the front end which is facilitated by quarterly business meetings within finance and with various business units which provides a 'pulse' on what is happening in the regions and what are their concerns. They are in regular communication with key departments such as legal, revenue and treasury and have developed very strong working relationships with people working in these departments (despite sometimes having conflicting objectives) so that tax gets a 'heads up' on transactions that may need to be addressed from a tax perspective. He also emphasised the importance of having as many 'touch points' as possible throughout the organisation to ensure tax gets involved where it should on a timely basis. To this end he spoke of the importance of him now dealing with trade compliance which gives him 'one more point of reference'. Similarly, two other interviewees spoke of the benefits of being a member of the trade group (in addition to tax). Perhaps having a role in a complimentary function is an important avenue for tax personnel to pursue (particularly in smaller companies) in order to raise the profile of tax and thereby getting it more involved in a wider range of business transactions.

Many of the factors identified here as influencing the extent to which tax is embedded in an organisation can also serve as catalysts for changing the role of tax within organisations. In any event, continually internally lobbying for tax, selling and educating on the role of tax, plays a significant role in determining the extent to which tax is embedded within the organisation.

While there was evidence to suggest that tax tends to be more embedded in larger organisations (Rego, 2003), the degree of embeddedness depends on range of factors ranging from the attitude of the CFO, to a change in profitability levels, to increasing risk levels arising from international expansion, to a changing regulatory environment and the extent of integration processes in place. A recurring theme here however is the idea that tax integration and embeddedness is facilitated mostly through good communication and relationship skills (Wilson, 1995; Holzman, 1965 etc). It is also useful when the head of tax is also responsible for some other function (for example Trade Administration) which provides important 'pulse points'.

4.6.4 Impact of CFO

For all of the companies involved in the study the tax function sits in the finance side of the business and almost all of the tax directors and VPs for tax report to the CFO. There was strong evidence to suggest that tax is more likely to be integral to business decisions if the CFO highly regards the tax function. The CFO therefore, is in quite a powerful position in relation to tax.

The concern raised by some interviewees around *a change of CFO* and the impact of this change on tax within the organisation provides more support for the view that the CFO's attitude to tax is extremely influential. Interviewees felt the tax function has to be sold again to the new CFO and this may create uncertainty. 'You don't know what he's coming in with, how he has done business before, what his expectations are of the tax department...we'll see how he pounces on me as to why our rate is what it is.' **(TE 15) TE 22 refers to** 'educating him on the issues that we have and how they differ from the issues that he may be used to seeing in his previous employment.' 'Well now I've got a new boss and.' **(TE 15)** TE 3 expressed the view that the tone of the Board and the CFO sets the tax culture in an organisation.[170] **TE 14** referred to his 'uphill battle to make tax more visible' as his current CFO does not have high regard for the possible contributions the tax function can make to the business. He

[170] See Chapter Six on the CFO's impact on risk culture also.

went on to say that tax, 'can be so much more effective with management that appreciate the value that can be added rather than seeing tax as just another cost centre'. This level of importance attached to tax by the CFO may be very difficult to change over time as it becomes 'embedded' in the organisation. A change to this level of importance may only come about through a change in CFO (the controller of resources), pressure from the peer group (organisational field), and changes in tax legislation or economic climate (economic and political level).

Some interviewees were quite happy with the level of interest shown by the CFO. **TE 2** has attributed the relatively new CFO with raising the profile of tax in-house among executives, by:

> Slowly coming around to really embracing tax...he is bringing us more into a lot of things early on...but we are definitely getting access to information sooner and I think that he is trying to make sure that we are included in a lot of the discussions.

This really demonstrates the power of the CFO. **TE 24,** while recognising the importance of having a CFO that understands and appreciates the tax function, did add a caveat that the tax function would always need to be successful. 'Success and results is what matters.'

The *background of the CFO* may well influence his/her perception of the tax function. For example, when the CFO does not have a tax background, he/she tends to be supportive but not eager to expand the role of tax in the business. Such CFOs are often not aware of the value that can be added through the tax function. The interviewees generally see part of their job is to inform and educate the CFO on the potential of the tax function to add value. However, CFOs are not always willing to listen and have well embedded views about tax such as 'it is a necessary evil'. **TE 14** spoke of his endeavours in his previous employment (also in the IT sector) to make tax 'more visible' to the CFO, but tax 'never became a priority. I quickly lost interest in him, in the company, and left'. It is clear that ideally (for tax) the CFO will 'have worked with and will have gained an appreciation for tax people before'. **(TE 14)**

The *length of time a CFO is with an organisation* seems to matter also, particularly where the VP for tax and the CFO have been working together within the one organisation for a long time. For example, one company's long serving CFO has a longstanding working relationship with the VP for tax which resulted in him having a 'a deeper knowledge of tax planning, the rewards it can bring, the difficulties of it, probably than most CFOs' **(TE 8)**. The result of this is that he has embedded tax into the 'culture of the company'. This CFO was responsible for commencing a post-tax basis of assessment, which would be an extremely contentious move for all of the other companies involved in this study. The CFO position is indeed extremely powerful. **TE 24** spoke of the importance of getting 'face time' with the CFO. Obtaining this face time may well be easier for tax directors and VPs who have been working with the same CFO over a long period of time which is certainly the case with some of the companies in this study (companies Five, Six, Nine and Fifteen), even in different capacities. A trust has been built up over years which cannot be undervalued.

The power of the CFO in terms of his lack of *willingness to understand and engage with tax*, and bring tax in at the early stages of business transactions was particularly evident in one company. Getting the CFO 'on board' was proving very problematic. **TE 18** had recently been almost thrown out of the CFO's office for raising tax concerns. He quoted the CFO as saying 'you are nothing but a chicken little — get out of my office'. This CFO may well be accused of taking the 'ostrich approach', quite simply not wanting to hear the problems. His view on tax is quite fixed believing it is 'something that could be done on the back of an envelope'. He is perhaps unlikely to ever permit (to the extent that it is within his power) tax to become a 'business partner' (Wilson, 1995). A change for the role of tax in this company may well necessitate a change of CFO.

A CFO's need to engage with and understand tax is driven to some extent by the necessity of *dealing with analysts' questions on tax.* Analysts, whose commentaries may have an impact on share price, are particularly interested in the company's ETR. What rate should they use for their modelling purposes and why? Why is it different to competitor tax rates? Analysts are members therefore of the organisational field with which CFOs must interact.

Whatever views the CFO has on tax, the nature of the relationship between tax and the CFO has to be right for everyone involved. **TE 13** summed this up nicely:

> He has to feel comfortable with us and the type of work and the level of work that we do. We have to feel comfortable with him that he understands exactly what we're doing and why we're doing it.

The CFO has emerged as one of the most powerful organisational actors in terms of tax being an integral part of how these companies do business. He/she appears to be very well positioned to engage in the necessary political processes associated with the institutionalisation (Covaleski et al., 2007) of tax, and thereby is a key player in setting the tax culture of an organisation. A new CFO can give rise to deinstitutionalisation and reinstitutionalisation. A CFO, in having to deal with analysts' questions around a company's ETR and so on, is an example of an engagement with the organisational field level (Dillard et al., 2004) which in itself pushes tax onto his agenda and thereby represents the dynamics of insitutionalisation within the tax domain (see section 3.4.1.4).

4.6.5 Tax Understanding the Business

The literature does allude to the importance of tax understanding the business (Wilson, 1995; Scholes and Wolfson, 1992). Such an understanding enhances the tax executives' abilities to become integral players in business transactions and to be strategically aligned with overall business strategy. This section provides the interviewees' views on the importance of having an understanding of the business, the extent to which they have this knowledge, and outlines what enables and prohibits in-house tax personnel from gaining relevant and sometimes necessary business knowledge.

Some interviewees felt very strongly about the need to understand the business. 'It's invaluable to understand what the business is about and how the business operates, absolutely essential to get any perspective on the tax analysis or the tax exposures or risks.' (TE 26) TE 14 said very firmly 'we better' understand the business because 'a head of a tax department that doesn't understand his business isn't any help to his company at all'. Despite this, many interviewees felt they did not have a thorough and complete knowledge of the business. However there are a number of factors inhibiting this from happening. Firstly, tax executives are so busy with 'doing tax stuff', they have a very limited amount of *time* available for learning more about the exact nature of the business, its products, manufacturing processes and so forth. Secondly, the companies *do not appear to require* their tax executives to really know the business in detail. The tax executives are presumably therefore in no way directly measured on their business knowledge per se, so acquiring such knowledge may not therefore be a priority. What is not measured may not get done. Thirdly, the *physical location of the tax personnel* vis-à-vis the operations may be a factor. TE 11 spoke of being 'disconnected' from the business as his office is based at Corporate in the US. Generally, it is easier to understand the business when one is physically located in the countries and offices where opportunities exist for 'bumping into people in the halls' that are dealing with the operations on a daily basis. Fourthly, some interviewees felt the technology industry was a particularly *difficult one to understand* where business models are often complex, particularly if you have not worked in the IT sector before. TE 26 described his company's product as 'invisible largely' and it would be easier to understand if the end product was something 'you can touch, see and feel'.

Opportunities to learn about the business do exist, which are availed of to different degrees and engaging in such learning seems to be 'up to yourself' and largely a 'self-service' system and the expectation is that tax executives should be proactive in this context. The one referred to by many interviewees was the *intranet.* 'It's amazing how much I could learn, for example, about [the company's] organisation and business and products and people just on our intranet site, if I had the time.' (**TE 9**) *On-line training resources and education* opportunities are made available by many of the companies. **TE 9** has a lack of time but said he learns a lot from *'hallway conversations'* which take place throughout the normal course of his required work. For senior tax executives overseeing the international tax function, they *travel to the regions* as much as possible and interact with the business people. TE 17 spoke of a previous SV company he worked for that would have twice yearly *European finance team meetings* at which business product and sales personnel present to the finance team (which includes tax) to update them on the business.

TE 8 is 'too far removed' to understand the company's businesses. However, he has assigned a tax department person to every business within the company. This *contact person* is thereby closer to the business and develops strong business and personal relationships in some cases with the business personnel (admittedly some better than others) and meet on a weekly, monthly or quarterly basis depending on the tax sensitivity of the different businesses. This facilitates tax staff being kept in touch with how the businesses operate and what developments are happening and being planned that may need a tax input. Similarly, **TE 24** spoke of continuous education taking place through 'business partnering relationships' among the senior tax staff, meetings of trade managers from around the world (this VP is in charge of the trade group the benefits of which were alluded to in the previous section), and many *employee meetings* where there are communications directly from the CEO, chief operating officer and CFO. In Company Eleven, the tax staff meets regularly for a presentation by a *guest speaker from the business* such as the chief technology officer.

While there was a consensus that a tax executive's integration with the business would be enhanced through a sound knowledge of the business (Wilson, 1995; Scholes and Wolfson, 1992), for the most part, such business knowledge seems to be at a minimum among tax executives in SV companies. Such limited knowledge is obtained on a 'self-service' basis, and with time clearly at a premium, where tax personnel are mostly working physically at a distance from the BUs, they are not rewarded directly for their level of business knowledge per se. The IT sector is inherently multi-faceted and difficult to understand and so perhaps this limited knowledge is to be expected. Only a small minority of companies have formalised business partnership relationships to facilitate tax executives understanding the true nature of the business. Does such business knowledge give these companies a competitive advantage? Or perhaps tax executives are not concerned because they know from each other that most executives in SV companies are in the same boat, thereby representing a form of institutional isomorphism (DiMaggio and Powell, 1991b)? This, in itself, may well reflect a 'cosiness' for tax executives within the 'black box' of tax. How can these executives aspire to being 'business partners' (Wilson, 1995) without understanding the business? Arguably, Wilson (1995) over-rates the importance of business knowledge in this context.

4.7 Summary

This chapter presented and discussed the key findings in relation to Research Question One and its associated objectives. The profile of each company's tax department was presented. Attention was drawn to the homogenous nature of the typical in-house tax executive in terms of professional qualifications and work experience, the very significant degree of centralisation of tax planning decisions that takes place in SV, strategic hiring of ex-IRS officials and Big Four tax partners, and various sources of power at play in determining the importance of tax planning in an organisation. The CFO emerged as a very powerful player in this context, which in turn directly affects the resources given to in-house tax executives for tax planning activities. The findings demonstrate a consensus around the need for tax to be strategically aligned with business strategy, but not driving it. Initiatives in place to secure such alignment are highlighted. Companies' tax strategies were presented, and in some cases the existence of a formalised strategy seems to be more about myth and ceremony (Meyer and Rowan, 1991) than a strictly adhered to document.

This chapter questions the capability of the Scholes and Wolfson (1992) approach to tax planning research to identify and capture all non-tax costs (frictions) and/or measure them accurately. A company's decision to pursue a less-than-efficient tax plan may sometimes be explained by its greater need to have its tax plans and overall approach to tax planning viewed as 'legitimate' (Scott, 2001).

5 Performance Measurement

5.1 Introduction

This chapter presents and analyses the findings in relation to the second research question. Research Question Two states: *How is the performance of the tax planning function measured in MNCs?* (see section 3.2 for associated objectives). Firstly, a number of observations arising from the interviews in relation to PM of tax generally are presented in section 5.2. This is followed by a representation and discussion of findings revolving around the specific areas of the effective tax rate (ETR) and post- versus pre-tax PM, contained in sections 5.3 and 5.4 respectively. These were the two aspects of PM that exercised the interviewees most and were recurring themes throughout the interviews.

5.2 General Observations

Whatever a company's approach to PM of tax is, as noted by **TE 19**, tax can be 'a difficult one to measure'. Many companies formally set objectives and goals, often on a quarterly basis (see section 4.6). The PM of the tax personnel then tends to revolve around the extent to which, and the effectiveness with which, these objectives are met. Other companies do not formally set out goals and objectives for the purposes of PM. According to TE 23, this lack of formality is due to *company size and tax budgets*. He identified the need to have larger departments and budgets to address this area by way of formalised goals and objectives.

Typical objectives of performance being measured include (although definitely not agreed upon nor used within all of the companies involved): timely and accurate compliance; tax personnel's ability to interact with its customers to provide timely and accurate advice; responsiveness to management's questions, issues and concerns; staying within budget guidelines; staying ahead on issues; 'keeping us out of trouble' with Revenue Authorities around the world; reaching settlements with the Revenue (extremely important for Company Seven);[171] impact on the 'bottom line'; dollars saved; successful and efficient completion of specific projects; presenting tax planning opportunities; tax risk minimisation; reacting to the unexpected (for example a Revenue audit); maintaining/reaching a specific ETR (see section 5.3 for discussion on ETR); and the cash tax rate. These measures are a mix of qualitative and quantitative measures, many of which are self explanatory, and their importance and usefulness were agreed upon by many of the interviewees. Such measures are not therefore discussed further.

Importantly, **TE 15** holds a very strong view that 'no-one in the tax department should be directly rewarded, a link created between the benefit they produce and their own compensation' (for example, decreasing ETR or saving a certain amount of tax dollars). He believes this gets 'some tax departments into trouble'. Such PM techniques do, in his view, encourage aberrant behaviour and may result in taking unwise tax risks. Interestingly, his argument continued that the tax personnel who engage in this tax aggressive manner may well have left the company by the time any

[171] Company Seven had recently succeeded in reaching a favourable agreement with the IRS.

ramifications are felt. He jokingly added 'I should have gone about fourteen years ago because you shouldn't stay or get audited right?'. This is a very serious point which exposes a very short-sighted perspective which some tax personnel may take towards tax planning. Arguably it should encourage tax authorities towards a shorter rather than a longer audit cycle.

TE 15 manages their PM process by producing a very summarised and 'very cryptic' list of achievements of the tax department which is delivered annually to the CFO either orally or handwritten on a piece of paper. This is then sent onto 'the Boss'.[172] This is done before bonuses or pay rises are decided on every year. When questioned about this somewhat mysterious process with apparent inattention to metrics, the sensitivity of this with respect to the IRS was evident: 'I don't really want it to fall into the IRS's or anyone's hands.' When asked about the nature of the achievements that might be listed, no specifics were given, but he said there are qualitative and quantitative ones and 'a lot of it has to do with is there a feeling that the tax department is in control of what's going on'. Interestingly, **TE 10** also emphasised the qualitative nature of PM: 'we don't use metrics for this stuff.'

Somewhat at the other end of the spectrum in terms of process, **TE 24** was very proud of the company's very formal PM system now in place for the last five years whereby all tax personnel have personal goals and objectives set up in such a way that there is a very clear alignment within the company of everybody's objectives and how their performance will be measured so that 'it aligns directly to what the company is trying

[172] 'The Boss' was the CEO and was named in the interview.

to accomplish and its gotten to be...a pretty good system as it's been perfected.' A key factor he identified was how well tax supports the business, namely 'business partnering'. Tax personnel in this company, rather exceptionally are rated by their internal customers (e.g. operations group, VP logistics) through administering a survey on performance against expectations and requirements and so on. The VP Tax has frequent one-to-one meetings with tax personnel to ensure everybody is clear on the objectives and to monitor how all of these objectives are being met. Interestingly, this company does not look to the ETR for PM as its overall tax structure is such that it has a very low ETR. It is important therefore for this VP to look to other measures of performance.

In relation to very specific tax planning strategies, TE 2 viewed the measure of success as 'is it *sustained on audit*', and are the tax benefits effectively kept intact? 'Audit' is rather comprehensive here incorporating internal audit, external audit, auditor's auditors and IRS audit. Rather amazingly, TE 18 admitted there is no formal PM of the tax function, which he attributes to the way the business is organised and its NOL position.

There was general support for the Douglas and Ellingsworth (1996) view that the CFO is the primary internal evaluator of tax, with one notable exception where all of the internal customers (from BUs to logistics) are involved in such evaluating. Most of the performance measures referred to in the literature (Porter, 1999a; Douglas et al., 1996) were mentioned by many of the interviewees, although not all of them were being utilised by any one company. A number of interviewees did emphasise qualitative rather than quantitative measures, and although PM was recognised as an important, albeit difficult function, there was no consensus on the degree of formality around the PM process.

5.3 Effective Tax Rate

The interviewees talked at some length about the ETR as a measure of performance of the tax function. Firstly, however I sought to clarify and assess the degree of consensus as to how a company's ETR is calculated and reported. Scholes and Wolfson (1992) provide two possible definitions of ETR as follows:

1. Tax currently payable and deferred tax expense/net income before tax (which they posit is popular for external reporting purposes);
2. Taxes paid currently/net income before tax (which is popular with tax reformers such as citizens for tax justice).

Having reviewed the most recently filed 10Ks of all of the companies involved in the study, the ETR is computed as the provision for income taxes/income before tax provision, which is in line with the first definition above. This is therefore, the definition based on reporting requirements and was also confirmed to me by some of the interviewees.[173] Importantly however, **TE 14** referred to another ETR that the investors and analysts are interested in which is a 'pro-forma' ETR based on the core business activities only and does not include the impact of items such as acquisitions, disposals, write-off of goodwill and so forth. Similarly, **TE 19** referred to being measured on a non-GAAP rate which is calculated based on 'our normal

[173] All interviewees were not asked to confirm their agreement (I dropped it from the questions I asked when I was happy the replies were consensual towards the first definition above).

operations'.[174] The process of how that is managed, monitored and communicated is very important as opposed to the actual rate itself. While being aware of the existence in some cases of the alternative operations only based definition referred to above, the following discussion is based on the first Scholes and Wolfson (1992) definition of ETR above and which is based on US GAAP. Table 5-1 sets out the 2004 ETRs for the companies calculated using this definition, based on the information contained in their 10K returns.[175] While Companies Three and Thirteen stand out for their relatively low ETRs, having an ETR in the high 20s/low-to-mid 30s would appear to be 'normal'.

Table 5-1 Effective Tax Rates

Company	ETR %
C1	28
C2	26.10
C3	8.10
C4	30
C5	16.7
C6	27.8
C7	32
C8	Tax benefit
C9	32
C10	36
C11	31.6
C12	18.8
C13	13.6
C14	35
C15	Tax benefit

[174] In the U.S. GAAP denotes Generally Accepted Accounting Principles i.e. accounting rules used to prepare, present, and report financial statements for a wide variety of entities, including publicly-traded and privately-held companies, non-profit organisations and governments.
[175] These rates refer to each company's 2004 year end which was not the same in each case.

Quite mixed views and opposing philosophies emerged in relation to ETR being used for PM purposes. In Company One for instance ETR does not feature for PM purposes at all. Some of the debate with respect to ETR in a measurement context revolves around meeting (or not) the forecasted ETR.[176] As pointed out by **TE 19** when the ETR comes in above or below the forecasted rate, there is then 'a communication between you and management to make sure that they understand what the drivers are in that and what may change it'. **TE 3** talked in terms of having an acceptable ETR range (27-35%) and staying within that range means 'nothing horrible is going to happen'. The latter means there are no negative repercussions for the tax function. Getting the CFO and others to understand that fluctuations outside of this range is mostly out of the tax function's control relates back directly to the continuing need for education internally about tax (see section 4.6). The forecasted or target ETR appears to be set (in some cases) by people outside of the tax function. For example, the CFO and company president at Company Three set the target ETR. Its tax director does not understand how it is decided upon and claims it may even be 'arbitrary' but is still 'my measure' and appeared to be quite content with this situation as he is currently meeting this objective 'comfortably'. Would his view be different if he wasn't meeting this particular objective comfortably? He did understand why tax directors might have a problem with being measured in this way as it can put 'pressure on you to perhaps do things that you might not normally do. It does incline you to be more aggressive' (**TE 5**). This provides some important insight perhaps into what drives and determines the tax risk profile within an organisation

[176] In accordance with US GAAP, an ETR is forecasted for the year, but each quarter this is re-evaluated, and if it changes the tax provision must be re-evaluated.

(see section 6.4 on tax risk profile). Similarly, TE 22 spoke of the CFO and the head of tax setting the objective ETR, he himself, being quite removed from and unsure of the process.

Company Five's tax group as a whole is measured primarily on the company's ETR so everything the tax group does is assessed in terms of its impact on the US GAAP ETR. More than 50% of what the Sr. VP for taxes in this company is measured on is the ETR. One of the interviewees at this company contrasted this with his previous employer (another one of the companies in this study) that believed the ETR does not impact on stock price and that it should not take on high tax risks (presumably with the intention of reducing the ETR) as well as its existing high technology and market risks. Again is the latter a possible explanation of a company's tax risk profile?

TE 8 was adamant about the appropriateness of ETR as a measure of performance, content that he personally can influence it. This is in striking contrast with **TE 14** who 'would never sign up for a job where bonuses were conditioned upon a certain effective tax rate or a certain amount of tax savings'. He sees these as being out of his control, 'based on law and...much more a function of statutory tax rates than of planning'. He believes that it is management that has not worked with tax before that tries to tie the success of tax with 'the amount of money that does not have to be paid to the government'. He argued that one would wish to be measured by something else when new tax reliefs are introduced which one's company simply cannot avail of. This raises the question as to what extent tax policy (through for example introducing certain tax reliefs/incentives), might at times interfere with the marketplace by facilitating tax planning for some companies but not all?[177]

Interestingly, the second individual I spoke with from this company who has responsibility in the EMEA tax compliance domain said the Director of Tax 'is probably monitored on the overall rate and why it is, what it is, and what we need to do to change it'. **TE 24** feels sorry for 'poor tax directors getting screwed', being measured on the ETR, a small portion of which they can control. He believes the ETR is an inadequate and inappropriate measure of performance as it is *accounting-based*. He posits that there are legitimate accounting alternatives available for transactions which facilitate changing or creating different ETRs on the same set of circumstances. Quite infuriated he said 'what kind of measure is that?' This suggests 'creative accounting' techniques can be employed to deliver the required ETR to the market. **TE 18** who would not want to be measured by the ETR posited, 'it's the business that controls your effective tax rate really...been going all over the place but that's as a result of the business side'. **TE 23**, while believing the ETR is very important was emphatic that in his organisation 'there is no pressure or goal to arrive at a desired rate'. They strive towards an 'optimal' rate, 'within the organisation and operation that we have and so there is no pressure to be entering into activities that don't coincide with our normal business operations'. For companies with significant NOLs, the ETR did not feature for PM purposes. However, it was very unclear as to how tax performance was measured in these companies. In one case it appeared that

[177] Further consideration of this question, while important, is beyond the scope of this study.

because the ETR was not appropriate, there was no need to measure the performance at all which is somewhat surprising.

Interestingly, there was evidence to suggest a link between the ETR and resources for the tax function, with it sometimes being used as a 'sword' to defend against inadequate resourcing, 'if we can't spend money on X, Y and Z the effective tax rate is going to go up two points'. **(TE 3)** 'If tax rate is going down and ...the company sees objective results I think he's [Sr. VP Tax] getting resources and will be able to continue to get resources in this environment'. **(TE 17)** For **TE 20** an important aspect of managing the ETR is that it shows, 'that a company is putting some resource, some emphasis on effective tax planning, to minimise what could be a pretty significant cost to the company'. This really does not sit well with the interviewees who do not respect it as a measure of performance.

TE 19 spoke of the possibility of doing some 'one time things' that would lower its ETR towards its competitors rate, but he and his company are against a one-time hit because 'it's too painful to have to go back'. Equally, going too low is 'very hard to sustain' and at some stage is likely to 'pop back up again' with possible negative consequences. Instead, his strategy is clearly to stick with a more consistent ETR performance over time. Notwithstanding the above, this company is cognisant of the competitors' ETR. When they look at tax planning ideas they address the short and long-term impact on the rate, what other companies are doing, the investment community reaction and finally talk it through with the executives. This process provides them with a balanced perspective on managing the ETR.

Indeed, predicting the ETR for the market (the Street), and the subsequent reaction by the investment community/market/street was a recurring theme in the discussion on ETRs. It appears that when a company sets a target ETR, it is monitored and changed typically on a quarterly basis, and fluctuations from the rate given to the market are generally perceived as not good news, which ultimately can impact on share price. [178] TE 3 referred to his company being criticised when the rate fluctuates as the analysts have built what turns out to be an incorrect ETR into their business models. Arguably, the market's attention to companies' ETR is itself a source of coercive isomorphism (DiMaggio and Powell, 1991b). As noted by **TE 21,** the ETR, 'is something that the investor relations side of things focus on big time...we know that the investor relations people and the Wall Street guys look at it so we have to look at it'.

The importance for these companies of having an ETR that does not fluctuate significantly and is competitive with peer group companies was highlighted by Advisor 3. This 'importance' however attached to ETR on the Street does not always filter through to the companies in terms of PM as seen above. **TE 11** believes the ETR is 'a lot more important I think to Wall Street' than to [his company], although the CFO does need to understand and be able to talk to the analysts about it. **TE 1** stated, 'if for whatever reason, for legitimate reasons, the rate is higher than our peer companies...that would be ok, as long as there was a good explanation for why'. This interviewee was more concerned however with explaining to the CFO rather than the

[178] Interviewing market analysts on the significance they attach to the ETR is included in section 8.4 as a recommended research idea arising from this study.

Street. **TE 15** described his mechanism for dealing with and managing market reaction. He said there are so many 'flying points' (factors which may influence the ETR) that he is only prepared to say to the market what its ETR will not exceed. He is not prepared to say what it actually will be.

Despite many interviewees' reservations about the appropriateness and validity of the ETR as a measure of performance, comparison of a company's ETR with its peer companies certainly happens, and seems to matter seriously to the tax executives, the CFOs, and the investment community.[179] **TE 8** for example, presents at least yearly to the Board concerning the ETR, specifically comparing and explaining the company's ETR vis-à-vis its competitors. He did emphasise however that this did not present a pressure which would make them more tax aggressive. Instead, he might 'work on resources differently, prioritise things differently'. Clearly, the Board are interested in the company's ETR (this interest could be driven by many things), which filters through to PM in the tax group. He sums up the importance of the ETR as, 'I think it's a competitive advantage to [my company] to have a lower tax rate than [a named competitor company] and I work on it' (**TE 8**). **TE 12** monitors its competitors and sees this as a 'key measure'. This interviewee raised specific concerns about not being able to match a competitor's ETR which is based on 'an extremely aggressive tax structure...we can only hope that the IRS goes after them from now on'.

[179] The investment community's interest clearly goes beyond this comparative context however as can be seen from the previous paragraph.

One really interesting aspect of PM with respect to how a company is doing vis-à-vis its competitors concerns the idea of absolutes versus relativities. **TE 26** suggested that having a very low ETR vis-à-vis your competitors may in fact pose a question mark in terms of tax risks, with the obvious possible negative impact on the market. He explained that a relatively low ETR:

> Attracts a lot of attention and the Board, the CFO may not necessarily see it as a positive to be sort of six points ahead of your competition...beating the market rate by extra points is not perceived to be a critical factor.

The view of his US-based colleague (who has greater visibility I expect) was a little different however. This colleague stated they try to be 'at or below' their competitors' ETR as they would see this as a competitive advantage.

TE 15 spoke of the rather lengthy and detailed presentation he used to do in the past to the Audit Committee (of the Board) explaining the differences between his company's and its competitors' ETRs. Part of this analysis involved trying to 'glean' what they could from the competitors' financial statements. This is not done any more as it was rendered 'meaningless'[180]. They discovered that even a company listed as a competitor (he named an example) has such a different business model, that they are not really comparable in any meaningful way. He believed that the market doesn't care about these differences. He did caveat this however by adding 'unless we were sitting there with a 40% effective tax rate or something'. His colleague in the interview did point out however another factor i.e. the 'CFO network'. When these

[180] This provides support for the argument that looking to financial statements for meaningful tax information is of limited value and was not therefore considered an appropriate predominant research method to employ in this research. See section 3.3.2.

CFOs talk to each other they become very aware of why other companies' ETRs may be lower than theirs. For example, there may be some structural differences and the CFOs often come back to the VP for Tax wondering why their company can't restructure to match or beat the competitors ETR so 'there is some level of comparison' with competitors taking place. The over-riding point here does appear to be having an awareness of why your rate is different to your competitors and to be able to explain this satisfactorily to the CFO. **TE 23** spoke of the need to 'explain to the CFO or in some cases the CEO the differences between the character of our competitors and ourselves'. The latter may be particularly relevant in the context of the companies operating in the SV area whose businesses and business models could vary significantly across a wide range of technologies.

While TE 2 claimed not to benchmark himself against competitors and claimed no external influences exist at all in terms of PM of tax, his boss (**TE 1**) did allude to the fact that he contacts a small number of companies in SV on an informal basis, 'keeping an eye on what other companies are doing'. In this way these other companies do have an influence on decisions and ultimately therefore performance and PM.

There is certainly a great awareness of the ETR among all of the interviewees. However, there is no consensus regarding the extent to which it is used in practice to measure the performance of tax executives, with only one company's tax executives being very content to be measured based on the ETR. The philosophical position of a number of the interviewees was very clear i.e. the ETR is an inappropriate measure of performance as it is not totally within the control of the tax executives, and may encourage aggressive tax planning if it were used to measure performance. It moves due to other factors such as business activity, new tax laws and so forth. In any event, as suggested by Slemrod (2005) a relatively low ETR may in the eyes of the 'savvy investors...result from a more aggressive stance that pushes the limits of what is legal' (p.95). I am not suggesting however, that all investors are the same and there may well be a 'clientele' very happy to invest in a company with a very low ETR, notwithstanding the degree of tax aggressiveness it might portray. Educating the CFO, the CEO and so on, as to why the ETR has fluctuated appears to be paramount in securing legitimacy and credibility internally. Nonetheless, the market, a source of coercive isomorphism (DiMaggio and Powell, 199b) attaches great importance to a company's ETR, and therefore managing it and explaining it is very important. The market is thus an important constituent in the organisational field level of the descriptive framework put forward in this study and the analysts are important actors at this level (section 3.4.1). Whether tax executives like it or not, they must pay attention to the ETR purely because this important organisational field member does so, in a way that could impact ultimately on shareholder wealth. This is somewhat concerning and dangerous, especially taking account of the fact that the findings do not really support the validity of the ETR as a measure of performance and it clearly seems to be subject to manipulation through creative accounting or flexible accounting standards (Bauman and Shaw, 2005).

Support for the inclusion of competitors and peer companies as important organisational field members in the descriptive framework (see Figure 3.1) was significant, with most interviewees being quite exercised with his/her company's ETR relative to competitor companies' ETR. While some interviewees believe a lower ETR is a competitive advantage, a relatively low ETR could also signal aggressive tax planning with possible negative consequences. The need for tax executives to be able to explain the basis of the difference between companies' ETRs to CFOs, the market and arguably tax executives/CFOs in the competitor companies appears to be very important and necessary and a mechanism towards achieving legitimacy (Scott 2001), often revolving around different business models. Such an explanation or understanding cannot be obtained through an examination of a company's published financial statements. It would appear the case for legitimacy is stronger than economic efficiency with respect to the ETR, itself a possible measure of economic efficiency. Identifying and recognising the influence of external constituents like competitor companies and the market enhance our understanding of 'the relationship between organizational structures and the wider social environment in which organizations are situated' (Hussain and Hoque, 2002: p.164). Strategically, many companies work on the basis that there is an 'acceptable range' of ETRs which will not give rise to any unwanted questions from analysts, or get unwanted attention from their peer group companies, thereby securing external legitimacy (Scott, 2001). This is arguably important for their personal survival within the SV tax arena.

Contrary to Karayan and Swenson's (2007) suggestion, comparing a company's ETR to the standard US corporation tax rate of 35% did not feature as important in the interviews. These findings do question the validity of the ETR as a measure of the effect of tax planning, yet it has been used by many researchers for that purpose

(Zimmerman, 2003; Mills et al., 1998; Rego, 2003). It should clearly continue to be used therefore with great caution as suggested by Phillips (2003).

5.4 Post-Tax versus Pre-Tax Performance Measurement

All companies in the sample except one, measure the performance of the business units and the non-tax personnel leading these units (typically VPs for different operations) on a pre-tax basis. Very strong views were held by the interviewees on this topic. Most interviewees shared the same philosophy and were clearly not in favour of tax being treated as a business expense of the business units.[181]

In the one company where the post-tax basis applies, the bonuses of the VPs of the different businesses depends in part on how much taxes his/her group pays so 'he cares a whole lot about taxes' (TE 8). TE 9 (with the same company) acknowledged the counter argument to measuring on a post-tax basis but explained why it can work:

> The businesses can get too aggressive and...unconstrained...a business could do all sorts of less than fully kosher things from a tax accounting view...it can be controlled and I think you have to have a strong respected central tax group that sets the rules.

TE 8 admitted this is politically a difficult area and most tax directors attitude would be, 'my gosh the businesses will run crazy with this stuff and they do. They will do anything now to save taxes and they do and you have to control them and you have to educate them'. In terms of who drives this PM approach, it goes firmly back to the CFO in 1984-85 who introduced it because he said 'the only way you are going to get

[181] In the one company which applies the post-tax basis, it applies to income on earnings only.

these people to manufacture stuff in Puerto Rico and Singapore is if we put it in their performance'.[182]

Only one other interviewee (**TE 2**) indicated that he would like to see a post-tax basis of PM because he is really big on 'accountability' and thinks 'it would be good to include tax as a cost of their business'. This view was not shared however by his tax colleague who believes the BUs 'are pulling tax in now as it is' (**TE 1**). Two other companies could see some merit in it but only in certain situations, but even then said it would be difficult to apply in an equitable fashion. TE 14 spoke of the difficulties with trying to assess on a post-tax basis referring to the fact that some countries like Ireland have a significantly lower corporation tax rate than others such as. Italy. Therefore these countries would have to be compensated differently. [183]

The predominant finding was that companies employ a pre-tax basis of PM on BUs and almost all interviewees philosophically agree with this approach. **TE 11** posited, 'I don't want the businesses worrying about the tax rates and making decisions'. His colleague (**TE 10**) agreed, 'absolutely, do not want ever to be measured on an after-tax basis...people should be looking at the business side of things and let the tax department worry about tax'. Specifically, in relation to transfer pricing it would result in tax executives constantly 'fighting with your operations...they all want to optimize their own P & L as opposed to what's the correct thing' (**TE 10**). This company held this viewpoint very strongly which is interesting as the two largest

[182] Manufacturing in these countries typically leads to lower tax payable by the manufacturing groups.
[183] Standard Irish corporate tax rate on trading income is 12.5% compared to 33% in Italy.

companies in the study held completely oppositional stances philosophically and in practice on this matter. **TE 18** was also keen to retain control over the tax expertise and focus:

> I don't think that the business should really concern themselves (sic) with something that they have zero control over. That's my job to come in there and try and control that...sometimes what happens is, what could be good for one group might be bad for another group and you'd have to have all these different battles all over the place.

TE 19's concern about moving to a post-tax basis is 'you start to get people focused more on the process than on what they really should be doing which is the core business'. **TE 23** would find the notion of post-tax basis as quite 'worrisome' and thinks it would put a pressure on business managers that he would not be comfortable with. He referred to the fact that many of the local operations are headed up by sales people and:

> The character of those people is to be aggressive and to want to achieve goals that they've established, or goals in most cases that they haven't established, somebody else has established for them and you know I would not want to see them under that pressure and therefore be susceptible to overly aggressive tax strategies.

All except one of the companies in this study measures performance of BUs on a pre-tax basis. The company which engages in the post-tax basis, is aware that it is part of a minority of companies in SV. Its approach however is well embedded, in fact 'institutionalized' (Powell and DiMaggio, 1991) as it was introduced by a very powerful internal actor over 20 years ago. The philosophy and practice within this company would not move I suggest, without a change at CFO level to somebody with an opposing philosophy. This would thus signify the role of the powerful actors or 'elites' in the institutionalisation process, who are themselves through their exercise of power 'sources of heterogeneity' in the tax institutional environment (Powell, 1991). However, the chances of this company employing somebody with an opposing view on PM are very slim I suggest, thereby demonstrating at times how unlikely deinstitutionalisation is to take place. A post-tax approach to PM is arguably at this stage a 'cultural rule' (Edelman and Suchman, 1997) within this company which explains some of its rules and organising logics (DiMaggio and Powell, 1991a) with respect to tax. Interestingly, this company is perceived as a 'leader' (Dillard et al., 2004) with respect to other tax-based activities (see Chapter Eight), yet it has not been followed by other SV companies with respect to post-tax PM. Another very large company in the SV, facing many of the same tax planning opportunities and challenges, does not share the post-tax measurement philosophy which again could be explained by an internal cultural perspective created and sustained by some powerful internal actor(s) in the tax domain.

These findings support the KPMG (2005) position that pre-tax PM still predominates. The tax executives for the most part were keen to retain a sense of power through being the exclusive tax knowledge experts in the business. Despite not being terribly close to the business, and not always understanding the business (as evidenced in section 4.6.5) they feel they are best positioned to address the tax implications of the business activities both in terms of expertise and character. It appears something of a contradiction to demand the BUs to consider tax (through early consultation with the tax executives) in their strategic business decision making yet not reward them for doing so through, for example, a post-tax PM system.

5.5 Summary

This chapter presented and discussed the key findings in relation to Research Question Two and its associated objectives. A number of key general observations relating to the practice of performance measurement in US MNCs was presented and discussed. For example, many of the performance measures referred to in the literature are employed in these companies ranging from timely and accurate compliance to reacting to the unexpected such as a Revenue audit. Some interviewees put a greater emphasis on qualitative as opposed to quantitative measures. The CFO emerged as a key evaluator of the performance of tax executives. However, there was no consensus on the degree of formality around the PM process. Two distinct aspects relating to PM particularly exercised the interviewees, namely the effective tax rate and post-tax versus pre-tax PM. Many interviewees do not perceive the ETR as being an appropriate measure of performance, yet they are very aware of it. and the interviewees need to be able to understand and explain to internal (the Board, CFO etc.) and external (market analysts) interested parties, its make-up and why it differs from their competitors' rates. The latter demonstrated clearly the importance of relativities over absolutes in this context. Only one company subscribes to and employs a post-tax measurement of performance to BUs. Most interviewees shared the view that a post-tax basis might only serve to increase tax risks, preferring instead for the in-house tax executives to remain the exclusive tax knowledge experts within their organisation, and to be rewarded on that basis.

6 Tax Risk Management

6.1 Introduction

This chapter presents and analyses the findings in relation to the third research question. Research Question Three states: *How is tax risk managed in MNCs?* (See section 3.2 for associated objectives.) It was important firstly to establish the importance of tax RM to these MNCs. The findings in this regard are presented and discussed in section 6.2. Section 6.3 goes on to identify the key types of tax risks that the in-house tax executives encounter and deal with, some of which are 'technical' tax issues while others are not of a tax-technical nature. Section 6.4 then provides insights into the tax risk profile of these companies as defined by the tax executives. The range of mechanisms and processes employed by the in-house tax executives to manage the various tax risks identified are addressed in section 6.5. Finally, the importance of having a formalised tax RM policy in place, and the extent to which these companies do this, are discussed in section 6.6.

6.2 The Importance of Tax Risk Management

The need to address RM at all in a tax context arises due to the inherent infallibility aspect of tax laws, which gives rise to uncertainty around their interpretation. Where there is uncertainty, there is a risk to be quantified and managed, which ultimately links RM with degrees of tax aggressiveness and attitudes to the law. As supported by **TE 14**: 'Tax laws, generally, are less than "black and white". There is always some room for "interpretation"'. Almost as a direct result of this alone, (leaving aside risk profiles, which are addressed in section 6.4) there will always be some companies (and individuals) who are more aggressive (or perceived to be so) than others and 'pushing issues to the "envelope"' (**TE 14**).

The interviewees were quite exercised about tax RM, an attitude which is driven partly by uncertainties surrounding the interpretation of tax laws (which is not new), as referred to above. They were also concerned about by what appears to be an increased level of interest in RM generally by Management in a post-corporate-scandals era (the impact of Enron was mentioned by many interviewees in this context).[184] This post-Enron environment presents a new risk terrain for these companies, consisting of new regulations (with increased penalties) and specifically, complying with the Sarbanes Oxley 2002 reporting requirements as they apply to tax.[185] As noted by **TE 21,** 'Sarbanes-Oxley pretty much ... rules the roost' and **TE 10** stated 'it has changed the world'. This is an important context within which to understand and reflect on the findings of this study with respect to tax RM.

The post-Enron environment has without doubt led to an increased interest in tax RM by Management (the CFO, CEO and Board of Directors were all mentioned by interviewees in this context), and the need for tax executives to keep Management informed of the tax risks to a greater extent than before has become part of the internal tax RM process. This appears to be leading generally to a more conservative

[184] This increased level of interest in RM is arguably also driven by the Big Four.
[185] See section 1.3 on Sarbanes-Oxley.

approach to tax planning within these MNCs.[186] **TE 14** sees an important part of his job as being to point out to Management the impact of being aggressive or conservative, and the risks and rewards: 'That's what makes tax a lot of fun'.[187] Likewise **TE 26** referred to issues that 'you might have left bubbling or you might take a view on, you now need to air and discuss and give guidance to the CEO as to whether it's appropriate to go with this'. In the context of the increase in documentation now required for RM purposes (due largely to SOX) **TE 24** said, 'you better be able to show that you've done this work and that you're managing that risk and everybody, you know the Board of Directors, the Executive Management want to see it'.

The following quotations reflect the apparent move towards conservatism in tax planning. 'I think CFOs generally now are a bit more accepting ... [and they] like to think more conservative.' (TE 17)

> A lot of the plans and ideas that were floating around a few years ago may still work but mightn't be acceptable at a business, political level...I would say culturally over the last seven or eight years the mindset of Management and CFOs is very much narrower. (TE 26)

TE 15 referred to tax plans being 'a lot more vetted' now (evidenced by the increase in documentation requirements) whereas in the past 'companies may have been a bit

[186]Another contributing factor to this conservative approach may be the US regulations which were introduced in 2003 to curb abusive tax shelter schemes. These regulations require companies to disclose tax shelters (as defined in the regulations) in their tax returns. Promoters of tax shelters are also required to register transactions with the IRS and maintain lists of participants. These regulations have since been amended (following the American Jobs Creation Act in 2004) and arguably improved upon in response to taxpayer and tax adviser concerns. See Lipton and Walton (2007) for a summary of these amendments.

[187] Others felt 'the fun' has gone out of tax.

more willing to try something...a bit more seat of the pants'. In light of this change he made a presentation to the Audit Committee. He needed to understand where that committee stood on the risk spectrum, and come up with some processes and a list of risks that need to be considered in the present climate. He said in the past there were things like the 'Wall Street Journal' test. He now spoke in terms of having something analogous to a spider's web that would represent the different risks ranging from a public view (a concern for 'legitimacy') to technical, to documentation and to the [CEO named] factor. In relation to the latter he stated, 'the last thing you want, the rich, one of the richest men in the world feathering his nest with tax shelters doesn't really read very well'.[188] He also referred to considering the:

> Atmospherics...there's a lot going on in the atmospherics right now...where judges are reacting very differently to things that are grey...we don't know what they're going to be thinking two or three years down the road. The pendulum may have swung back, don't know, it may have landed in a sensible place.

TE 12 referred to positioning and posture. 'I think that in itself it's just ...how well you document it, how well you position yourself and your posture. I mean, if you're looking aggressive then you're going to be aggressive.'

While this increase in interest of Management changes the nature of tax executives' work to some extent, it also gives them more visibility internally and perhaps therefore more opportunities, which is evidence of the enabling and constraining

[188] While a tax shelter usually refers to some method of reducing one's taxable income, and thereby one's tax bill, some tax shelters are legal and legitimate but others may be illegal or certainly questionable in ethical terms. It is the latter to which this interviewee was referring in this context. In the US, efforts at preventing the misuse or unintended use of tax shelters include tax legislation and judicial doctrines (for example the substance over form doctrine).

action referred to by Dillard et al. (2004). Section 6.3 addresses the different tax risks currently facing tax executives in these US MNCs.

There is evidence here to suggest that the uncertainties around some tax laws, combined with an increasingly regulated environment which has resulted in an increased interest in tax by Management, has led to a trend towards more conservatism in tax planning generally. Uncertainty in itself therefore appears to some extent to result in effective tax policy (McBarnet, 2001a; Spilker et al., 1999) if the latter amounts to conservative or low risk tax plans. This, I believe, is subject to debate and represents a 'tension' at the economic and political level of analysis. As regards increased regulation, SOX appears to have unveiled (in a new way) a formal authority structure (Fligstein, 1991) within the MNCs by pushing tax onto the Boardroom agenda, thereby attaching an increased importance to tax RM.[189] The latter, of course, is a clear example of the dynamics of institutionalisation (Dillard et al., 2004) as represented in this study's conceptual framework (see Figure 3.1).

Concerns with legitimacy (Scott, 2001), both within and as perceived by the 'public' with respect to tax executives' tax RM, are clearly very important and are evidence of the different audiences to whom their claims for legitimacy must be articulated (Perrow, 1985). In this message on the importance of the *perception* around the practice of RM, procedural legitimacy (Scott, 1987) featured more prominently in the interviews than the exact nature or quality of the practice itself. Being in tune with the

[189] Not dissimilar I suggest to the post-Cadbury Turnball environment as referred to by PWC (2001).

'atmospherics' of the situation is an important part of RM, which includes having one's ear to the ground, networking, knowing how judges are thinking and so forth. This all demonstrates the impact of the activities and actors present at all levels of analysis as depicted in this study's conceptual framework (section 3.4).

6.3 Types of Tax Risk

While a number of types/areas of tax risk were specifically identified by the interviewees (as detailed below), many of them spoke of fear of the unknown, of missing something through, for example, not being kept informed. **TE 10** described this well:

> The biggest tax risks facing an organisation like [company name] are the ones we don't know and can't assess...what's out there that you don't really have visibility to...it's the great unknown that's the biggest risk. The rest of the stuff we manage.

The primary tax risk areas identified by the interviewees are summarised and discussed below, and represented in Figure 6-1, the first four of which are grounded in specific tax technical domains.

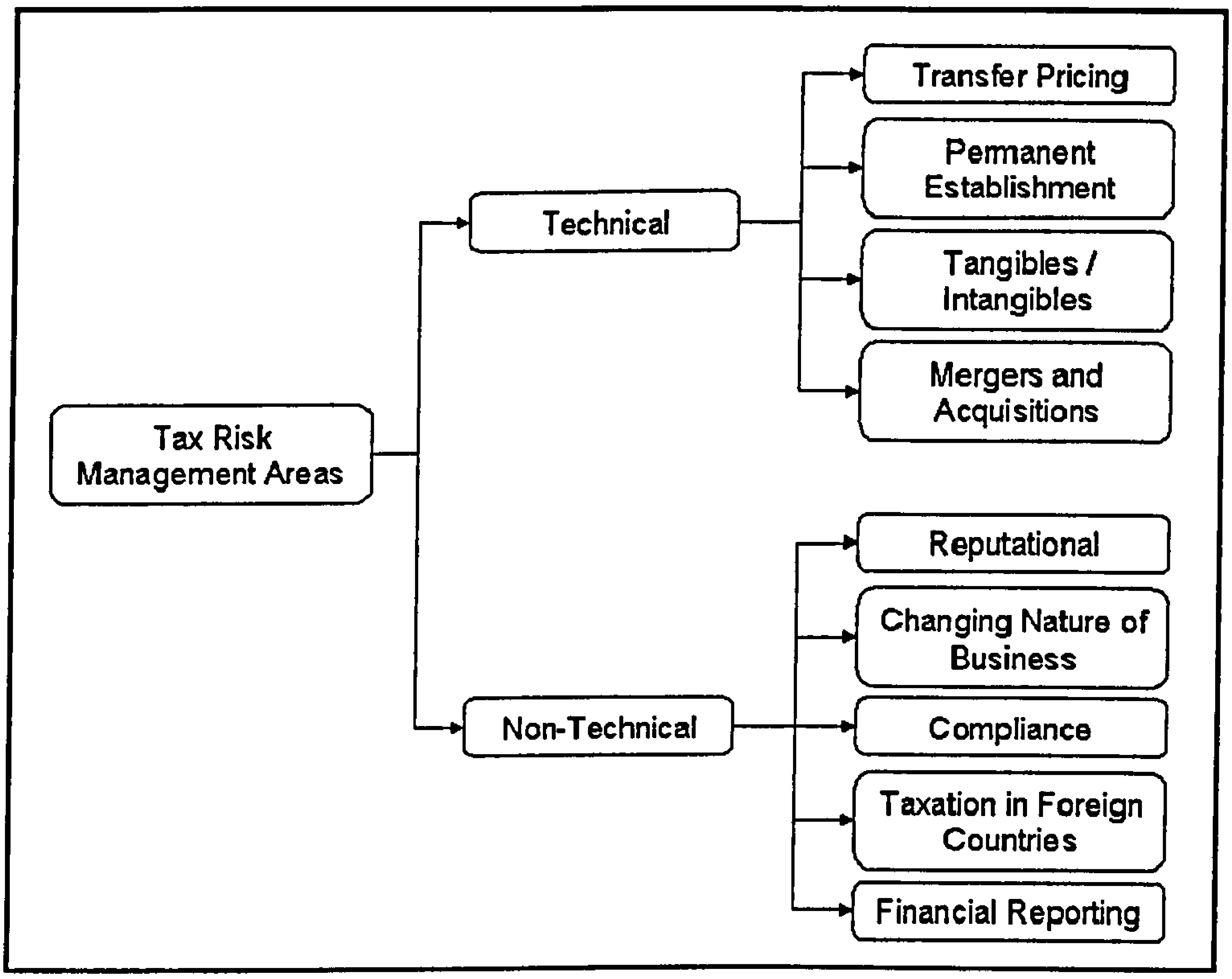

Figure 6-1 Primary Tax Risk Management Areas

Technical Issues

- *Transfer pricing (TP):*[190] This was referred to by almost every company and for the most part it was first on their list. As evidenced by the following quotes, the MNCs appear to be 'pawns' in the battle for revenue between different tax jurisdictions. 'More and more countries are getting more aggressive on transfer pricing and so you have a transaction between two corporations in the group and each tax authority wants their fair share.' **(TE 1)** 'We don't want to pay on the same income twice or three times but you often get two or three jurisdictions who are fighting over the same profit. So to me,

[190] See section 1.3 also on transfer pricing.

to a multinational, that's the biggest issue.' (**TE 17**) 'Every government wants to have a bigger piece of the pie.' (**TE 18**) 'Now it's a tug of war around the world and you know you've got to pool the profits and you've got 25 countries all saying we want our share...it's an extreme challenge.' (**TE 23**)

For **TE 9,** TP underlies the fact that their ETR is driven by 'how much profit is booked in the factory in Ireland versus how much is booked in the US and so on'. A related issue mentioned was that foreign audits (as opposed to US ones), especially in Asia, Korea and Japan which are 'becoming more aggressive', and were moving TP up the tax risk agenda (**TE 3**). Similarly, **TE 11** referred to many foreign tax jurisdictions taking 'totally unreasonable positions' on TP and that the number of countries now seeking documentation is growing exponentially (40 countries require TP documentation which they categorise as 'Tier 1' risk). Interestingly, **TE 8** believes his company's rapid growth has made them a 'huge target' of tax authorities in this context.

- *Permanent establishment* (PE)[191] or 'a son of transfer pricing.' (**TE 23.** Interviewees referred to the risk of the subsidiaries doing something that jeopardises the integrity of the tax structure. In this context **TE 12** stated:

> People like to move parts around all over the place and product around and you know it's more fun with that as long as we can keep track of it and I think that's where we would struggle the most.

[191] See section 1.3 also on the importance of the concept of 'permanent establishment' for tax purposes.

TE 16 referred to some countries (India was cited) sending conflicting messages to MNCs. The countries want them to do business there but then the tax authorities come after them on a PE issue. What did they expect?

- *Tangibles versus intangibles?* **TE 15** highlighted the constant risk concerning the inherent nature of their products, identifying in particular that their product (software) does not 'fit into a nice mould' so they are 'always grappling with the fact that we're in the grey anyway'.
- *Mergers and Acquisitions:* Company Five executives specifically referred to the possibility of acquiring a company with tax liabilities they were unaware of (despite apparent due diligence).

Non-Technical Issues

- *Reputational risk.* As pointed out by TE 15, this is a risk that must be assessed even though it cannot be measured from a 'pure tax opinion standpoint'. Not surprisingly, the bosses' attitude to risk tends to matter here as reflected in TE 3's comment, 'if the Board of Directors is conservative and we are in line with that, that's great. So I think it's more alignment, knowing what the bosses want'. This alignment seems to be more important in the post-Enron environment. The idea of going to tax court came up in this context and TE 3's response reflected the company-size factor. His view was that large companies (he cited GE and IBM, neither of which partook in this study) do not mind going to court as they see it 'as a cost of doing business' whereas smaller companies would probably prefer not to go to court. These interviewees were also of the view that reputational risk was a bigger issue in the trade area than tax, because of the politics involved (e.g. the US losing business to China). 'The politics involved with tax are just basically tax people...nobody really necessarily cares on a broader political level to the extent they would from a trade level.' (TE 3) Interviewees were very concerned about the role of the media in the context of reputational risk. 'We try not to do things that'll get us written up on the front page of the Wall Street Journal.' (TE 22) 'We take a very, very careful look at the risks involved and I guess the guiding principal is would you want this in the newspaper and if the answer is no...you probably shouldn't do it.' (TE 5)

> You want to be able to wake up every morning and not see your name in the headlines of the Wall Street Journal as having done something bad. I think that is absolutely the truth with regard to the tax department as well. We feel very strongly that we never want to be the poster child for some bad thing. (TE 2)

The potential impact of the media on tax planning also clearly exercised

Advisor 1:

> With the number of financial media and the number of financial journalists clamouring around trying to fill column inches, with bullshit most of the time, you really have to plan against a background of an assumption that whatever you do may be subject to media commentary, and as a consequence, you need to apply the smell factor and the smell test to a particular transaction or scheme or tax plan in the context of potentially being exposed in the media, and ... in a manner which you might not necessarily want it to be exposed. You have no control over what way a journalist perceives something.

Similarly, KPMG (2005) stated:

> Tax has news value now and, although often unfounded, 'naming and shaming' attacks on alleged tax avoiders can damage their reputations in the eyes of important stakeholders, which can lead to sharp short-term

> share price falls and the unwelcome attention of more than one taxing authority. (p.16)

Of course one can sue the media for any incorrect data being published but it is likely some corporate image damage would already have been done by that stage. **TE 8** cares about reputation a lot:

> We tout our uncompromising integrity, it's a big thing for us and just within the tax function, as I told you, I think our reputation helps us a lot. So I care about our tax reputation too. It is a big thing for us.

TE 22 believes reputational risk is 'huge'. **TE 15** is concerned about the '[CEO named] factor' as referred to in section 6.2. Can such a high-profile CEO actually impact negatively on a company's tax planning activities? **TE 24** is concerned because of their Cayman Islands-based structure and particularly about the impact of a negatively-toned article having a negative impact on the stock price. **TE 18** is more concerned about his personal reputation because SV is so small, but he did acknowledge that personal and company reputations are inextricably linked, 'if I keep my nose clean, the company keeps their nose clean. I mean in that sense I am the company.'

- *Changing nature of the business* which brings new risks to be managed which, if not adequately resourced, can become enhanced. Company Five executives spoke of moving into the service industry, while Company One executives spoke of moving into retail. These businesses can be very quick to market and may present new areas of risk.

- *Compliance risk*. This incorporates completing returns and ensuring the correct amount of tax is being paid (companies do not want to overpay either). Interestingly, **TE 14** emphasised that sometimes they knowingly take a compliance risk. This happens due to having minimal tax resources, which means they cannot get to everything.[192] A 'business decision' is taken to prioritise what gets done and a calculated risk is taken on the rest. Very importantly, senior management are warned and informed about this risk and he tells them:

  > I don't have a head count resource so this is being neglected, I do not have the time, the bandwidth or the resources to get to this. You need to know, so that when it comes back around you don't hold me responsible. **(TE 14)**

  If the risk is 'significant enough' a reserve will be put in place but if it becomes 'chronic' he will argue for more resources and then it becomes a management decision as to how to go forward. Advisor 3 also referred to the trade-off between the cost of compliance and the risk of sanctions. This type of trade-off seems to be particular to smaller firms for which the cost of compliance can be so significant. Linking this risk with reputational risk, **TE 21** said: 'it reflects badly on ... the company as a whole if you're being fined, reported, that sort of thing' for non-compliance.

- *Taxation in foreign countries*: A number of interviewees referred to local country issues. **TE 7** identified some uncertainty around 'how a country will take a look at how we should be taxed'. Concern was raised about Japan

[192] For example, VAT-specific compliance requirements for which they cannot afford to acquire the expertise to deal with.

(Companies One and Two), China and the Eastern Bloc, 'where the tax rules aren't all that worked out and they don't necessarily have a rational way of dealing with these sorts of questions' (**TE 15**).

TE 12, while recognising that movement into other countries is often driven by labour (cost and availability), comments that 'tax is the place where you can make the mistake that costs you more than the labour saved you'. I think this is a very significant point when companies are looking at longevity of structures. The constantly changing tax laws around the world present tax risks: 'what may have been in total conformity with law and regulation at one point in time, due to legislative changes or court rulings and court interpretations, might change'.(**TE 5**)

- *Financial reporting risks* which incorporate the relatively new SOX reporting requirements, 'a brand new risk' (**TE 14**). If tax is materially incorrectly reported such that a restatement is required, that can be embarrassing and 'the company's reputation is shot with its analysts, with its investors, with its employees' (**TE 14**). This issue is thus linked to reputational risk. Setting tax reserves (a 'cushion') is clearly RM in action as **Advisor 3** stated: 'The reason companies have tax reserves is because there are risks out there'. The quarterly reserve-setting process has, as a result of SOX, apparently become a painful and extremely heavy administrative burden and is recognised as 'a big issue in the Valley' (**TE 24**). Effectively, in this process, the company is being overseen by the auditor, who is being overseen by the PCAOB.[193] The impact of PCAOB was clear, with one interviewee identifying it as now having the most influence in this area. 'We do what the people who measure them [the auditors] count and that oversight body can put them out of business, so they do what that body tells them to do.' (**TE 8**) SOX extends tax risk to processes as explained by **TE 1**:

> I think that has increased the implications of tax risk tremendously and so it's not...just risk on tax issues, it's risk on your processes and so Sarbanes Oxley is looking at your processes for putting together reserves, tax reserves for example, and so you have got two issues there: it's one are your reserves right but the other thing is were your processes you used to get to that also appropriate. So you could have the right answer on your reserves but if you have poor processes to get there, then you could have a 404 failure even though your reserves are right on.[194]

SOX has, according to many of the interviewees, pulled resources from planning and value-add activities to administration and is not very popular among the interviewees. It's an 'overkill' (**TE 15**), 'killing a fly with an elephant gun' (**TE 23**), 'the obvious eight hundred pound gorilla in the middle of the room' (**TE 1**). SOX has led to 'a bunch of terrified people' (**TE 2**) and is largely perceived as the consequence of the actions of a few 'bold' individuals/companies and the others are 'paying for their sins' (**TE 5**).

TE 8 was clear on how SOX came to be. 'Why we have Sarbanes Oxley is because of Enron. So the rest of us weren't doing that stuff, so it's too bad...we all got tarred with that brush.'

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[193] Some interviewees referred to more changes expected in this process through new FAS 5 rules also. See section 1.3 and footnote 13 for explanation of PCAOB.
[194] See footnote 13 on SOX and S 404.

There was certainly some scepticism around whether or not SOX will reach what it set out to achieve: **TE 18** believes that government will see soon that 'it wasn't worth it...it's already starting to move'. **TE 14,** extremely annoyed, commented, 'it's not going to stop the larger companies from doing these things, but it is going to be an excessive burden financially on the small companies'. Similarly, **TE 2** stated 'I am not sure that all the policies and procedures in the world would have stopped some of these major offenders'. Importantly, there was some concern expressed over the copying or borrowing of SOX-type regulations by other countries in which these MNCs are operating:

> My sense of it is that each government will view some type of rigorous documentation program as good, good no matter what. I know that Sarbanes Oxley has every multi-national scared and many other countries are adopting very strict Sarbanes Oxley-like rules.(**TE 2**)

Other risks referred to very briefly included Subpart F[195](referred to by Company One executives only), strategic risk (is tax aligned with the corporate objective?), use of tax attributes (as discussed earlier), cost and legal risk.

These findings support the existence of all three types of tax risks identified by PWC (2001): operational, planning and compliance, with which tax executives are dealing.

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[195] As noted by Scholes, Wolfson, Erickson, Maydew and Shevlin (2005) the Subpart F CFC rules 'are designed to prevent firms from forming paper foreign corporations in tax havens to record income from passive investments, sales, services, shipping operations, or oil-related activities. In general, these rules work by subjecting Subpart F income to U.S. taxation as if the income was repatriated to the U.S. parent when the income is earned, rather than when the subsidiary distributes cash to the parent' (p.295).

However, the interviewees were very concerned with reputational risk, a friction (Scholes and Wolfson, 1992), at both a personal and corporate level. I think 'reputational risk' overlaps conceptually with 'legitimacy' (Scott, 2001; Carruthers, 1995) in the NIS literature. The role of the media in this context was particularly striking, making the media now, I believe, an important 'actor' at the organisational field-level of analysis. The media is a rather powerful player and is something of a subtle catalyst in this apparent trend towards conservative tax planning referred to above. It may well be the media that is responsible ultimately for a change in the attitude (McBarnet, 2001a) of some tax executives to the law, succeeding in a way that numerous tax law changes, including the introduction of 'super principles' (McBarnet, 2001b), have failed in the past. The public, a well-recognised audience of legitimacy claims within NIS through its interest in the media, in this context may well be having a greater influence on the nature and practice of tax planning than was originally considered possible.

Financial reporting risks, largely resulting from SOX-imposed requirements, are evidence of how a company's auditors, who themselves are overseen by and accountable to the PCAOB, demonstrate the penetration of significant organisational field-level actors on the organising logics (DiMaggio and Powell, 1991) of the practice and process of tax RM. The PCAOB is an important actor identified in the descriptive framework (see Figure 3.1). The general consensus certainly is that SOX has given rise to much tension in the various relationships between all levels of analysis as depicted in the framework and its success has been received with some scepticism. The reactions to this are ongoing, continuing the dynamics of institutionalisation.

Foreign tax authorities have been clearly identified as important economic and political level actors, giving rise to many concerns for US tax executives. There are uncertainties around dealing with foreign tax authorities, particularly around the idea of foreign authorities copying already unpopular US tax rules and practices. Transfer pricing and SOX were highlighted as areas within which mimetic isomorphic behaviour (DiMaggio and Powell, 1991b), often a response to uncertainty, at international level, is in evidence or being considered, with associated tax policy implications (see Eden et al., 2001 on transfer pricing and Carpenter and Feroz, 2001 on GAAP).

6.4 Risk Profile

All interviewees were asked to describe the tax risk profile of the company. The risk profiles, as described by them are summarised in Table 6-1.

There are clearly some issues around the use of language here. For example, what does 'conservative', 'aggressive' or 'cautiously aggressive' mean in this context? While a detailed discussion on this matter is beyond the scope of this study, it was clear that the interviewees were drawing on the same types of words to describe their companies' risk profiles. There appears to be a recognised and accepted vocabulary around risk profiles. Using these terms therefore (without a detailed discussion on their precise meaning) in this discussion is justified. However, the additional comments on some of the companies' risk positions that follow here do bring some clarification to the various meanings.[196]

TE 2 believes it is his company's conservative approach that meant he did not (fortunately, according to him) get 'on board with some of these ideas that these investment bankers brought through years ago and there are a lot of firms, there are a lot of companies that have been caught by that'.[197]

Table 6-1 Risk Profiles

Company	Risk Profile
C1	Conservative
C2	Conservative
C3	Risk averse
C4	Risk averse?
C5	Aggressive but not 'slimy'?
C6	Very ethical and pretty risk averse
C7	Not hugely aggressive
C8	Conservative
C9	At 75 on a scale of 0 to 100 (100 being very aggressive)
C10	Not answered directly
C11	Fairly conservative
C12	On the conservative side
C13	Pretty conservative
C14	Conservative
C15	Cautiously aggressive

[196] Relatedly, whether or not a tax plan is considered aggressive, the distinction between tax avoidance and tax evasion remains a critical one in this context. See section 1.3 for a brief reference to this distinction.

[197] This interviewee was referring to potentially illegal tax planning ideas, often referred to as 'off-the-shelf' tax plans which have no commercial substance.

While the Company Four executives did describe the company's risk profile as 'risk averse', it was very quickly qualified which might lead one to question the appropriateness of the profile descriptor they used:

> We take very aggressive positions but then we get rulings to shore those up. So ... when I first came and our prior CFO was here, his attitude was he wanted to set the precedents in Europe, in other countries, not get stuck behind a bad precedent from another country. (**TE 7**)

I then asked if they actually set out to be a leader in that sense to which he replied, 'Yes, from day one, back in July of 1999'. So 'risk averse' for this company incorporates what they consider to be 'aggressive' tax plans but ones for which they have sought rulings on, which, I assume, no longer makes them aggressive. Not all interviewees might agree with this interpretation of 'risk averse'. **TE 10** was keen to point out: 'to be really frank we're a very conservative company with the highest business ethics on the face of the earth'.

TE 8 was happy to describe his company's profile as aggressive but was very anxious to distinguish that from being 'slimy'. They did not do 'very aggressive transactions...when everyone was accused of doing particularly aggressive transactions and we also haven't swung to the other side'. He did add that they do not:

> Shy away from doing sophisticated tax planning and in fact my strategy on credibility with government authorities and I think they would still tell you that [his company] is an aggressive, I use the word now, [his company] is doing tax planning, they know that and when they look at that they say hey that's pretty clever but it's never slimy.

So does this align sophisticated tax planning with aggressiveness? These are difficult distinctions to make without clear definitions and examples. Importantly, the reference here to RM in the context of having a 'strategy on credibility with government authorities' highlights the facts that such a 'relationship' exists between these companies (through their tax executives) and government authorities and that importance is attached to it. Chapter Seven addresses the nature of this relationship and its wider theoretical implications.

While, for the most part, the interviewees referred to their companies' profiles, there was also evidence to suggest that the head of tax brings his/her own personal profile to the table and essentially only stays with a company that has an overall risk culture/profile that matches his. For example, **TE 14**, who said his company's profile was conservative, added that he has been pretty conservative throughout his entire career. He gave the clear impression that he simply would not choose, or certainly would not stay in, a company whose tax profile was aggressive (in his eyes). Therefore, some people 'pick' the risk culture that suits them and others try to create or influence a culture towards the one that suits them. The conservative approach taken at his company was also explained in terms of its size and therefore the cost of a mistake:[198]

> I take a risk with [my company] and it could cost more money than this company would want to spend on a mistake and [another named much larger SV company] might go out and attempt to be more aggressive. [My company's] gross revenue is five days worth of sales for [the other named company], so that is a size perspective and...a two million dollar mistake in

[198] There is some evidence therefore to suggest that there is a relationship between company size and aggressiveness, but the full nature of this relationship is difficult to ascertain.

> [the other named company] is rounding whereas a two million dollar mistake at [my company], I'm fired. Big difference. (**TE 14**)

Interestingly, **TE 15** introduced a numeric scale to describe the company's tax risk profile:

> I don't think its tax conservative...I would say you know if you're from zero to 100 and there's the aggressive and ... the middle of the road is 50, we're at 75...when the guy comes in and talks about you know 'I really want to use Cayman Islands' with some particular sort of structure with zero tax and ... two guys and a mailbox. I don't think that's the type of thing this company would fund, whereas some companies might be very excited and willing to do that.

While the use of such a scale brings some clarity to a company's risk profile, I think there are still issues around defining what different points on the scale really mean without more concrete examples. Understandably, the interviewees were not prepared to go into more details on the exact transactions they were entering into and the tax risks attaching to them.

TE 24 provided some explanation of the term 'cautiously aggressive'. Within the constraints of the law this company will 'operate to whatever tax benefit we think we should. So we don't give anything away but we don't stretch'. Is he an advocate of the 'letter of the law' approach but also applies the 'smell test'? Company Eleven's conservative approach comes from the top levels of management who are 'very conservative' and don't want to see [the company's] name 'in a bad way on the front page of the Wall Street Journal' (**TE 19**) (see section 6.3 on the impact of the media). They have not gone with some of the tax planning techniques they have been approached with over the years, 'we just can't get beyond the look of the smoke and mirrors thing'.

TE 21's comment demonstrates well the difficulty around the use of language in this context:

> I think that it would be more on the conservative side than the aggressive side in that you know if we can come up with good tax plans ... we'd need to be sure that they're pretty water tight before we'd push the boat out.

To 'push the boat out' could, but need not necessarily, be aligned with tax aggressiveness, which may question the appropriateness of using the term 'on the conservative side'.

The above statements show that these individuals consider their risk profile to be mostly conservative, with a limited number of responses moving into the 'cautiously' or moderately aggressive classification. They were all very keen to distance themselves from non-commercially-based tax planning activities. It would be interesting to have somebody else classify the tax risk profiles of these companies, for example the IRS, the auditors or tax advisors. **Advisor 3**'s comment generally on what he believed is the stereotypical profile of 'tax people' arguably supports the risk profile descriptions revealed in this study. They 'tend to be more analytical than your average Joe, so I would think if we threw a dart at the general public, the average person would be more seat of the pants than your average tax person'.

These findings address Maydew's (2001) call for understanding differences in levels of aggressiveness in tax planning among firms. Some understanding has been provided here, for example as to why some companies chose to be 'leaders' (Dillard et al., 2004), as opposed to 'late adopters' in terms of implementing innovative — or what might be considered 'aggressive' — tax-based structures (albeit on the back of an advance ruling). They consider it in their best interest to set the precedent rather than taking the risk that someone else may set a precedent that doesn't suit them, a 'bad' precedent from their perspective.[199] These SV-based companies also find themselves in a particular situation where the products and business environments are changing rapidly and some companies simply do not have the time to wait for others to pursue certain tax-based structures first. In that sense these 'leaders' chose to manage their own destiny. The influence of the media (an important organisational field-level actor) was again evident here as a driver of risk profile. The personal risk profiles of the tax executives themselves also play a role. There is evidence that 'tax risk clienteles' exist whereby if tax executives do not agree with their companies' appetite for risk, they either align themselves with it or move on to another company whose appetite for risk matches their own. While many of the companies in this study could be categorised as 'growth companies', there was no evidence to suggest that such companies would be less aggressive (Shackleford and Shevlin, 2001).

6.5 Mechanisms of Tax Risk Management

A range of mechanisms, practices and processes (identified in italics in this section) are employed by tax executives in these MNCs to assist them in managing the various tax risks discussed in the previous section. These are summarised in Figure 6-2. Some companies seek *advance rulings* from the Revenue Authorities (more popular apparently outside of the US, as securing them in the US seems to be a relatively

[199] Where there is ambiguity about the legitimacy of a particular tax based structure, once the Revenue Authorities give their approval, typically that becomes a precedent to be followed or adopted 'safely' by other companies and therefore without much risk attached.

lengthy process). **TE 7** told of how they took this approach in some large EU countries when they took positions which they described as 'contrary to what we call "brick and mortar" positions' and used these rulings as their defence in the smaller countries. They were adamant that they 'led the charge in Europe' on some issues and had companies like Google, and PWC/Deloitte partners calling them 'to kind of, like, nose around the edges of what we were doing and how we did it'.[200] **TE 3** enters advance pricing agreements (APAs) with respect to TP in foreign jurisdictions.

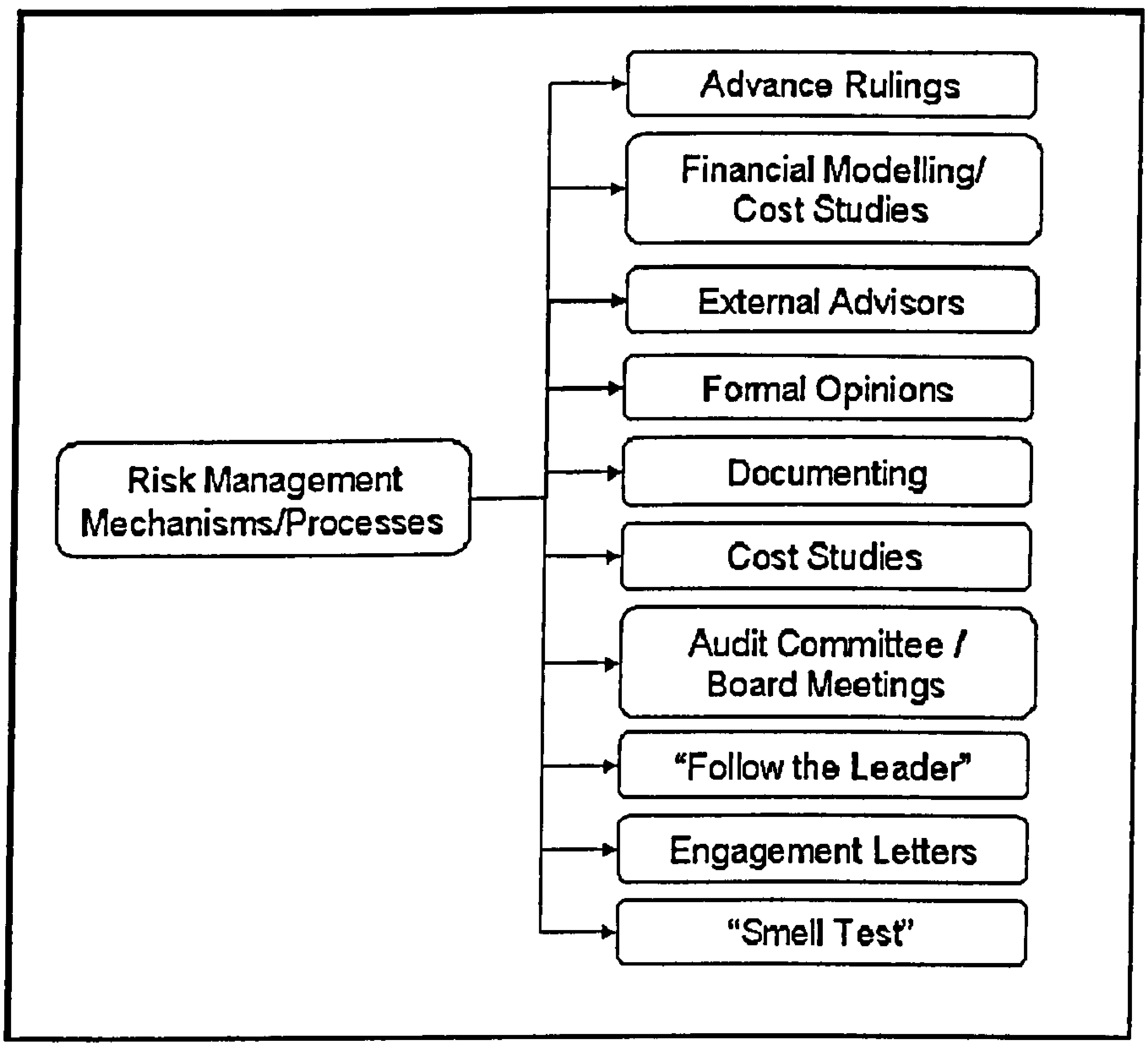

Figure 6-2 Risk Management Mechanisms

TE 14 referred to engaging in *financial modelling* and obtaining advice from *external advisors*. **Advisor 1** spoke of the tension between the tax advisor and the client with

[200] This describes well how the organisational field works and how tax plans are diffused.

respect to risk management. At times the client just wants an informal opinion but sometimes they want an 'insurance bond'. These *formal opinions* constitute part of RM practices for some companies whom the client 'would intend to rely on if things went wrong and relying on the professional indemnity cover that Big Five or Big Four firms have' (**Advisor 1**). Unsurprisingly, **Advisor 2** also mentioned this but thought the clients wouldn't like to admit it:

> It's almost like an insurance policy, getting a sign-off by one of the Big Four. In terms of their risk management, it means that they have done their due diligence and PWC has signed off on it, or KPMG or whoever.

TE 25 referred to internal culture and personalities within the organisation driving this need to have back-up from an external advisor. It is perhaps to do with:

> The conservative nature of the people who are here now, part of it is because of the pain the company had to go through to fix the things that didn't happen years ago, that this is never going to happen again. So we have kind of gone from one extreme to the other.[201]

TE 6 spoke of the importance of *documenting everything* 'so that we're not caught unawares if we are on an audit and we have to go back and ... fill in the gaps'. SOX requires all controls and procedures to be documented and tested and **TE 6** portrayed this as a good thing arising from SOX. Being SOX compliant amounts in part to RM in practice. **TE 12** referred to having *cost studies* to mitigate risks where the concern is not so much with audit but with saving the company from penalties. He needs to be able to show that he used some due diligence on rates and percentages used.[202] Company Nine executives referred to their *meetings with the Audit Committee* to

[201] This point is also connected with this company's overall approach to RM and its efforts towards a strategic alignment of tax.
[202] While needing to 'show' that some RM processes are carried out is important, the quality of such processes is less clear.

establish their position on risk and agree the various risks to be assessed when considering tax plans. **TE 24** has also recently presented to its Audit Committee on RM, as this committee had heard that tax was putting various processes and procedures in place.[203] Once in place, this company will engage in *Enterprise Risk Analysis.* SOX has to be given credit, he believes, for driving all of this. He emphasised however, that these new procedures will not really change things. Perhaps this exposure to the Audit Committee is a good thing for tax, presenting opportunities and helping to push tax up the corporate agenda. Only a small number of interviewees referred to going to *the Board* itself on RM within tax. The need for this seems to revolve around the amount of money involved, with **TE 22** going to the Board 'for large dollar amounts', maintaining risk and quantum go hand in hand.

One tax executive stated that part of his organisation's RM strategy is to *follow the leader.*[204] He referred to a small number of large SV-based companies that are considered leaders ('innovators' per Dillard et al. 2004) which have 'implemented everything that other companies want to implement'. **(TE 14) TE 21** deals with cost and legal risk by getting *Engagement Letters* from the service provider, which cover the cost and the scope of the project.

Despite having formal mechanisms in place to facilitate dealing with risk, interviewees referred to the continuing need to apply 'judgement', which amounts in

[203] Practices like this one would constitute 'good practice' in accordance with the HMRC's and KPMG's (2005) recommendations towards putting tax on the boardroom agenda – see footnote 22.
[204] Mimetic isomorphism.

many cases to applying the '*smell test*' (**TE 3** and **Advisor 1**) when dealing with uncertainties around the interpretation of tax laws. This is inextricably linked with debate around abiding by the letter of the law versus the spirit of the law (McBarnet, 2001b; Porter, 1999a). Interestingly, **Advisor 1** described essentially a pecking order of approaches to this. The preferred solution is one that:

> Meets the client's requirements, that is, within both the purpose and the word of the legislation because it is less likely to be seen as aggressive and less likely to find disfavour amongst the Revenue Commissioners in whatever jurisdiction.

The next level solution could leave one more exposed, with a reliance on a technical interpretation of the law, perhaps involving 'contriving' a situation to bring oneself within this technical interpretation, which is at odds with the purpose of the law. The exposure here would be to the possibility of actions against the taxpayer under anti-avoidance legislation (specific or GAAR in some countries).

The evidence indicates there is a wide range of mechanisms and processes employed in MNCs to manage tax risk. These range from seeking opinions from external advisors [205] (a 'guarded opinion' perhaps as per Hoffman (1961)) recognised as actors in the organisational field (DiMaggio and Powell, 1991b), to applying a 'smell test' or perhaps as noted earlier, assessing the 'atmospherics' of the situation. Some interviewees referred to 'followers' and 'leaders' in this context (Dillard et al., 2004) providing general support for PWC's (2001) position that competitors have a significant influence on acceptable risk and RM processes, which lends itself clearly

[205] See McBarnet (1991) on the practice of 'opinion-shopping' with a view to securing the opinion one wants.

to institutional isomorphism (DiMaggio and Powell, 1991b). Despite employing the various processes and mechanisms referred to here, it was difficult to ascertain whether such 'rational' processes are more about the way RM is presented to the outside world as opposed to actually reflecting the practice of RM (Carruthers, 1995). In this case they may best be described as loosely-coupled systems which relate to the different environments in which the tax executives operate (Scott, 2001).[206] Many of the interviewees would argue that RM per se has not changed, but is just documented better now. Perhaps it is a little too soon to comment on whether such documentation is mythical (Meyer and Rowan, 1991). In any case I suggest the 'smell test' may often best account for (although not articulate nor explain) how a decision is made in an area involving tax risk.

6.6 Formalisation of Tax Risk Management

All of the interviewees clearly recognised the importance of tax RM, particularly in the increasingly regulated post-Enron environment in which they operate, however, rather surprisingly none of the companies have a formalised, documented tax RM strategy or policy in place. Only one spoke of a corporate-wide RM formalised policy, with which tax is aligned, being in place. Despite this, all interviewees felt that they have an understanding of the risk profile of the company, and all but one could state what that profile is (see section 6.4). For **TE 3**, RM is simply 'set really by the tone of the CFO'. **Advisor 1** also attached significance to this:

> The tone at the top is always an important factor...if the tone at the top is compliant then it is less likely generally that you are going to find non-

[206] These environments include auditors, shareholders, general public etc.

> compliance down below. If the tone at the top is to have an absolute focus on minimising cash tax, then it is clearly more likely that certain compliance issues and that certain aggressive stances are going to be taken and less likely that directors will be able to sign off on.

This has significant implications for SOX compliance which requires such sign-offs.

TE 2 admitted not having a RM policy but added: 'you are making me think a lot, maybe we should'. **TE 9** is comfortable with not having a formalised written up RM policy:

> We may not have a written policy, but we certainly talk about that a lot and we know how we think about it, we talk about what kinds of aggressive tax things we don't want to do and why we might not want to do them.

TE 10 referred to having controls in place around reviews and compliance as opposed to having a documented RM policy. Interestingly he told of a recent conference at which he spoke on tax RM and recalled how far off [his company's] view was from the company represented by the other speaker. His company's goal is to file correct tax returns and have no tax audit adjustments. The other company's view on the tax return filed is that it is 'the opening offer to the IRS', and the final position is for negotiation. The other speaker thought this interviewee was out of his mind. This is arguably further evidence of tax risk clienteles of which policy makers should be aware.

Some of the companies just did not see a need to have a formally documented tax RM policy. In **TE 18**'s view it would be very difficult to have one. 'I think what happens is it gets measured by our reserves.' Company Thirteen does not have a formal RM policy in place, nor do its tax executives know of an overall corporate RM policy being in place. However, there is a checklist of questions they go through which reflects their RM approach and has probably developed over time through experience. These questions are:

> How is it going to show up in the financial statements? How is it going to show up on a tax return? How is it going to look for tax accounting purposes? ...what kind of documentation are we going to have? What advisors are we going to have to talk to? What opinions are we going to have to get? What issues are being raised here?...is it manageable risk? Is it just, a matter of...we pay a little more in taxes if they decide to do this or is it something that is going to create a bigger issue down the line for us? **TE 22**

Exceptionally, as previously noted, Company Fourteen has an overall company risk policy with which tax aligns itself, which basically indicates that the company will not violate any country laws, will engage in responsible reporting and so forth.

Contrary to PWC's (2001) recommendations, these findings suggest that companies have not formalised their tax RM policies. Importantly however, all of the interviewees do perceive themselves as engaging in tax RM through various mechanisms (see section 6.5), but do not see the need for having a documented, formalised tax RM policy in place. They cannot be charged therefore with any decoupling (Meyer and Rowan, 1991) in that regard. The CFO, through his role in setting the tone in terms of a company's approach to tax RM (albeit evidently not through formalisation of a tax RM policy), was clearly reinforced here as an actor within the tax arena with significant power, the exercise of which is itself an avenue of institutional reproduction (Powell, 1991).

6.7 Summary

This chapter presented and discussed the key findings in relation to Research Question Three and its associated objectives. Tax RM is clearly important to these

MNCs and their in-house tax executives. This importance is driven in part by the recent increased attention being given to tax by Management generally (CFO, Board of Directors etc.). This latter, in turn, is in response to the increasingly regulated post-Enron environment within which these MNCs are operating, together with the associated media attention. Continuing uncertainties around some tax laws however ensure a continued need to address tax RM. Overall, the evidence suggests a trend towards a more conservative approach to tax planning generally being adopted by these MNCs. There was a strong message from the interviewees on the importance of the *perception* around the practice and processes on RM. The interviewees identified specific technical-type areas of risk (ranging from transfer pricing to mergers and acquisitions) as well as non-technical areas (ranging from reputational to tax in foreign countries) that need to be managed. Interviewees described the risk profile of their companies as mostly conservative, with a limited number of responses moving into the 'cautiously' or moderately aggressive classification. The CFO was identified as a key influencer of a company's tax risk profile, and some tax executives choose companies who share their own personal philosophy on risk and RM.

In the rapidly changing business environment within which these MNCs operate, some interviewees have chosen to be 'leaders' or 'innovators' of tax planning ideas (albeit subject to advance rulings in some cases), not having time to wait for others to set the precedents. Different mechanisms of RM are employed by the interviewees, ranging from obtaining advance rulings to the engagement of external advisors. Applying the 'smell test' and assessing the 'atmospherics' of the situation however remain important less formal RM mechanisms that are in place. Notwithstanding the importance of tax RM to the interviewees, they do not have a formally documented tax RM policy in place and do not perceive such formalisation as important or necessary.

7 Tax Planning and the External Environment

7.1 Introduction

This chapter presents and analyses the findings in relation to the fourth research question. Research Question Four states: *What is the nature and impact of the relationship between the tax planning functions within MNCs and the external environment?* (See section 3.2 for associated objectives).

Section 7.2 identifies key actors in the economic, political and organisational field levels of analysis as depicted in the descriptive framework presented in Figure 3.1. These actors are present in the external environment within which in-house tax executives engage in the practice and process of tax planning. Section 7.2.1 deals specifically with the work of professional institutes/organisations and their interaction with in-house tax executives. Section 7.2.2 outlines the 'relationship' between the Revenue Authorities and in-house tax executives, while section 7.2.3 addresses other external influences on in-house tax executives. Section 7.3 addresses the extent to which the MNCs invest in external affairs and direct lobbying with respect to tax legislation.

7.2 Actors in the External Environment

This section presents the findings relating to the members and actors of the economic, political, and the organisational field levels of analysis as depicted in the descriptive framework in Figure 3.1. It was considered very important to describe this wider tax arena, as perceived by the interviewees, who are themselves important actors at the organisational level, before going on to examine the nature, and impact of the relationship between the tax planning functions within MNCs and the external environment.

There was significant consensus as to a number of key members/actors of the external environment: professional institutes/organisations, Revenue Authorities, media, peer companies, the European Union (EU), auditors, tax advisors, the US Securities and Exchange Commission (SEC), and Congress, as discussed below.

7.2.1 Professional Institutes/Organisations

These findings suggest the interviewees are themselves members of an extremely well organised professional world. In comparison to the situation in Ireland, for example, TE 26 commented: 'At US level the whole tax professional world is a much more structured, organised world'. Appendix 6 lists the various professional institutes referred to by the interviewees. The interviewees and/or some of their tax team executives are members of these organisations. The appendix contains a brief description of the raison d'être of these organisations as per the organisation's website (where one exists). These institutes are important actors at the organisational field level of analysis. A number of these organisations/institutes were discussed in some detail in the interviews and the principal findings of which are summarised below.

It was clear from the interviews that the tax executives of the MNCs, with one exception interact at significant levels with professional institutes such as the Tax Executives Institute (TEI), the National Association of Manufacturers (NAM) and so forth. Some of the interviewees are more actively involved than others in the running and agenda setting of these institutes.[207] The institutes vary in terms of their impact on the practice and process of tax planning in the MNCs in this study. It emerged throughout the interviews however that there are a number of key roles provided by these institutes. The interactions between the tax executives, the institutes, and the economic and political level actors (e.g. IRS, Congress) arguably impact significantly on the practice and process of tax planning in the MNCs, and on tax policy within and outside of the US. These roles/interactions, as supported by the raison d'être of these organisations, (see Appendix 6)[208] revolve around the provision of continuing tax education, networking opportunities, lobbying or business advocacy work, research and an array of avenues which facilitate the sharing of information among the tax community in SV, all of which are discussed below.

In relation to *education,* the TEI was recognised by many of the interviewees as a particularly excellent provider of tax education in a 'continuing education process' (TE 3), through its 'highly informative' (TE 5) and very well attended seminars. TE

[207] For example, in relation to the TEI, some of the interviewees are or have been president of the SV Chapter and some are Board members. One interviewee is the former head of the international TEI organisation.
[208] For example, 'open dialogue regarding tax policy', 'exchange of ideas with government tax officials', 'sharing', 'networking programs', lobbying governments' are all phrases used to describe what these institutes do and facilitate.

6 finds it 'fantastic' for technical updates. **TE 3** believes the SV TEI chapter 'is probably more active than any other one in the country'.[209] **TE 11** agreed:

> We have probably the most active chapter in the country. We will get anywhere from 125 to 200 people to our seminars. A lot of those are on the international area because a lot of the companies here are US exporters so they've got a lot of outbound international.

Rather interestingly, **TE 19** added, 'it's interesting to see, just by how many people attend, how hot a topic is'. **TE 14** recognised the quality of the seminars. 'And its good technical stuff...we get a high tech tax update monthly...from a local perspective, it's great'.

Attendance at the educational seminars and conferences hosted by the various institutes facilitate *networking.* TE **7**, on attending TEI seminars commented, 'it is good for networking just because you're seen, the people in...the Valley here are going to go to those'.

TE 8 posits such networking can even result in obtaining cheap tax advice:

> We go to the conferences and I think it's nice, very helpful to know other tax people, they will give you their tax ideas free as compared to the firms that will charge you for them. So I think we get as many ideas from other tax payers and so we are big on the Tax Executives Institute.

Other tax executives referred to the seminars providing, 'an opportunity to meet and we get hot items, hot issues are always discussed'. **(TE 14)**

[209] The TEI has various chapters around the US. The interviewees attend the SV/Santa Clara chapter seminars. TEI has more recently put in place chapters in Europe and Asia.

> A place where people can interact and network and establish relationships where they can pick up the telephone and call somebody or just at these seminars because they see each other once or twice a month on this stuff. (TE 3)

A small number of the interviewees, despite recognising some potential benefits of networking, did not themselves network very much for different reasons. **TE 24's** explanation is interesting (particularly considering an NIS perspective):

> I think TEI has got value because you meet a lot of people and knowing people is helpful...I've met a lot of people over the years and it's good, you know, if you have somebody you know well and you can call. Unfortunately the people I know are all retired or are retiring and so I've lost, I'm losing my base rapidly.

TE 20's explanation revolves around time pressure when attending a seminar and personality:

> I personally am not good about it because if it's a half day seminar I am usually anxious to get back here and get back to work and I don't really have time for the networking....I personally don't take as much advantage of it as I should...I think some people are better at that just personality wise.

Similarly, **TE 2** explained:

> You're going to think I am anti-social. I really don't network very much...I can see in certain situations I have gone out and talked to other tax directors in the Valley to see what their groups are doing on a certain issue, how do you address X, Y and Z. But generally speaking, I go to these seminars, I don't run around trying to meet other people, don't do that kind of day-to-day benchmarking or discussion. I know that other people in our department are very active in that and I see the benefit of it but again it's just not something that I do.

There was evidence to suggest a significant level of networking activity generally between the tax executives in SV and beyond, outside of the more formal fora provided through attendance at seminars and conferences, resulting perhaps in 'networks of power' with important implications. **TE 11** referred to his VP Tax being 'fairly well known in the tax circles'. He described a key player in the High Tech Tax Institute as 'a real mover and shaker in the tax community'. **TE 18** described the tax community in SV as being 'a very robust tax community, very, very'. **TE 12** referred to using a 'private network' when researching the best tax plans and structures sometimes shying away from formally engaging external advisors. **Advisor 2's** comment is particularly insightful in the SV context:

> In the US what does surprise me is, particularly within an industry and here we are talking about technology...people within the industry tend to talk to each other, so they would all know each other,...they move around as well which is why they all know each other.

TE 18 referred to the existence of 'clubs, social clubs with the head of tax in those companies to find out what's going on over there'. Interestingly **TE 20** suggests networking is part of the job:

> As a tax director or VP of tax or whatever you are, in that position, you are much more visible and you are really looked at as knowing what is going on within the industry...if one CFO talks to another CFO from another company and that CFO says, 'oh yes our tax group did this, this and this'...If the CFO comes and says "well why didn't you implement this planning idea?"...You say, "'I guess I didn't know about it'". So, you need to know and I think more and more so especially with Sarbanes Oxley, you need to be...much more in touch with what the business is doing, certainly within the company but also relative to, I think, to the rest of the industry, what other companies are doing, because you are really responsible for all of that (sic).

Similarly, **TE 18** when referring to CFO roundtables emphasised the need to:

> Keep your fingers on the pulse of those guys...so you know what's being said out there so you know how to react. You also know if you find out who, which Boards your CFO sits on in other companies because...whatever happens over there it'll come right back.

The benefit of networking was addressed by **TE 22**:

> It gives an idea of what other companies are doing and you know one tax director said 'I'm not a very good tax director in that I don't come up with very many ideas on my own...but I'm very good at using other people's ideas'. And I think that's a lot of us you know(sic)...What are you doing? What works? What doesn't work, you know?

Notably, he went on to express his desire to keep some tax plans out of the network, '...sometimes you wish they wouldn't take it public but you know because it's a good idea and you don't want anybody to know about it'. (TE 22)[210] **TE 16** described the workings of a rather elitist network of tax experts:

> We're on a number of tax mailing lists where tax, leaders of tax groups communicate. So, if there's an issue that you know one big company has come out with they sort of hop it out and it goes to the top tax guys at big companies...so there is a fair amount of communication among the Tax Directors sort of circuit as to, you know, current issues that are going on.

In relation to *lobbying* or 'advocacy work' (**TE 11**), some interviewees felt the TEI's contribution was more around education and networking than lobbying:[211]

> Is it moving items? No, I would say that more where you see policies being set instead of procedures is like more of the Tax Directors' Group...TEI only effects change when there's major pronouncements that are coming down and they will speak to those pronouncements and they'll give out their opinion on something.

TE 13 did however applaud the TEI's 'very masterful writers who will write up on behalf of the Institute and submit that to the IRS or submit that to the Congress'. **TE 14** described the TEI from a national perspective as:

> A watchdog for all of us. When legislation is coming out they have a board of advisors and they're reviewing the proposed legislation...They will, as an organization, say 'We with all of our thousands of members across the country, this is how we view this particular issue'.

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[210] When I was in practice there was always this balance on some tax plans between telling clients but perhaps not too many and not the 'wrong' ones.

[211] Lobbying seems to be conducted at a national organisation level as opposed to chapter levels within the TEI.

Lobbying is at the forefront of the Silicon Valley Tax Directors Group (SVTDG) activities. Its relatively high annual membership fee of $10,000 is to cover its lobbying activities:[212]

> It's the lobby fees. They're not trying to make money. What they're having to do is pay the person in Washington DC that will take their lobby message to whoever it needs to go to...they represent some huge companies and Washington listens to huge companies. (TE 14)

TE 3 explained how this group operates to satisfy all members in this context:

> There are certain issues that are important for some people, other issues for the others and we were all pretty much equals in that process. So we put together a set of recommendations, we were very good about being equal. We do a great job.

When asked whether they manage to always have a single voice on things, he replied, 'I think it's in part because we like and we respect each other and we just always have operated that way'. I got the impression that many of these people are 'friends' as well as tax colleagues and these friendships go back a long way. One interviewee however was not so content with the relevance level of issues being addressed by this group for his company:

> A lot of small companies in that group...It's not like there is something wrong with them but I find... I have the same issues in a lot of cases that General Motors and Ford have. So therefore I care more about being in a big company group in a lot of cases. (**TE 8**)

TE 16 referred to the important lobbying avenue of the US India Business Council, which he said is coordinated with the US Chamber of Commerce. He has been going to meetings (in his capacity as a member) with various tax authorities and Indian

[212] TEI annual membership costs only $200.

foreign dignitaries raising concerns about US business issues. Through this forum he gets to meet US-based executives from non-US development offices (e.g. Ireland's Industrial Development Authority).[213]

In relation to the *sharing of information* between tax executives from different companies, **TE 18** posited 'there's an awful lot of sharing. I mean we really are in a lot of this together'. **TE 19** referred to a certain amount of concern around 'what's everybody else doing and what is the current thinking and we get that through different seminars and different groups that we belong to'. **Advisor 3** believes the TEI is 'very influential...it is the professional organisation for in-house tax people. So it is a very useful forum for in-house people to share information.' The SVTDG facilitates the sharing of information in a more focused and relevant way as it has only 38 members from the largest companies in SV, and all facing many of the same issues:

> If you've got $500 million in sales you know you don't have time, you don't have the resources and your issues generally aren't as complex. So you're really looking at companies like, you know, $1 billion and plus or $2 billion and plus. Well there's probably only 30 of those...The guy at a start-up he's got different problems you know. He's trying to figure out how to file his tax returns...to make sure he meets payroll and...if you had the top 30 Silicon Valley companies involved, if you had [named four large SV based companies]...well you know as you get further down their issues are just you know, it's just there isn't as much to share. **(TE 17)**

According to **TE 3**, the SVTDG gets together once a month and:

> Shares problems, concerns...and that is where a lot of sharing takes place. There are competitors in that group and one guy in particular who I have

[213] This has broader inward investment policy implications for countries such as Ireland i.e. strategising by physically placing your inward development promotions staff within the cluster. The latter is beyond the scope of this study.

> known for years is good about calling and asking what have you done in France for example on this particular issue.

He did mention however that some companies are not as forthcoming as others in the group. Manufacturers Alliance (MAPI) was specifically identified as being really effective for sharing information among tax executives:

> It's one of the best I've ever seen at a relatively low cost...and what you do is you can just send an email out and there's this list that goes out to the MAPI tax list and it shoots out to the 200 people that belong across the country and which are the tax directors...and you send this email out with a question, what are you guys doing about this? And boom! In 30 minutes you get back 50 replies. 'Here's what I'm doing'. (TE 3)

The High Technology Tax Institute based at San Jose State University appears to be a very impressive working model facilitating education, networking and sharing of information, and rather exceptionally engages academics with practice. It appears to be a very well respected forum in SV, with many of the interviewees having presented at its conferences and sitting on its advisory board. 'It's...really...very good and because it's here's in Silicon Valley it doesn't cost very much money'. (TE 16)

There was a definite sense throughout the interviews that the extent of sharing of information that goes on in SV is particular to tax. TE 9 addressed how this sharing of information works between competitor companies:

> It even surprises me sometimes. There is even some degree of information sharing, shall we say, between obvious competitors...if hypothetically...[a named company] has a good idea, it doesn't necessarily hurt them if we take it but if they are getting something in return...most of the information sharing would tend to be let's say within a [named company]. For example, I have known the people at [that company] and [our Sr. VP Tax] has known the tax people at [that company] for twenty years or more...there is a lot of history there and there is a lot that we can share...there can be sensitivities there

> because we are a customer of them and sometimes the business relationships between a company like [our company] and [their company] or a [another named company] for example, major suppliers to [our company], can be, there can be real tensions in those relationships about contracts and prices and stuff like that. But we seem to be able to put that aside generally on the tax side.

TE 5 emphasised caution around sharing information with competitors. 'There is a limit to how far you can go...it's touchy, you have to be careful...you can't talk about pricing at all, no pricing, no market shares, any of that kind of stuff.'

Some interviewees, who according to them, are perceived as leaders felt others are more interested in them than the other way about, suggesting the sharing of information does not necessarily operate in both directions to equal benefit: '[Our company] can be very arrogant but you know a lot of times people want to know what we're doing'(TE 11). One interviewee referred to a fair amount of communication taking place among the tax directors as a, 'sort of circuit...periodically I see an email coming my way...from some other tax director who has popped this out and says an agent is asking this question about this, you know ...has anyone seen that?' (TE 17)

Some companies look to take the lead from other companies when deciding on whether to pursue a particular tax plan:

> There was dozens of times in the process of putting [the Irish structure] in place that the question would be 'Is this/has this been done by other companies or are we the first out of the box?' I am not, for a company the size of .... I am not at a risk taking position. (TE 14)

Likewise TE 12 in this context said, 'We do look at, we do talk with other companies in similar situations for ideas on how they approach a problem'. On peer company influence TE 1 said:

> Well, there is probably some influence because we do on certain issues we'll go out and benchmark. So if we are trying to figure out what we are going to do in a certain area...we may call up some people we know at other companies, on an informal basis, nothing formal, but not a formal study like you would do a sort of more scientific study, call up two or three people at other companies and say, 'Hey, what are you doing about this issue?'. And that might have some influence on the decision that we make...I think it is a relatively small tax community here in Silicon Valley and I think we are always keeping an eye on what other companies are doing and I think it does have an influence on decisions.

TE 3 provided an explanation of the willingness to share information:

> Maybe various influences on that, one of which is that we are by ourselves in the corporation and so there is not much sharing other than what we have here. So we have TEI, we have the Silicone Valley's Tax Directors Group. I look at the operations accounting guys and they have issues across divisions, so they share on divisional issues but for us we can't share with anybody other than people on the outside.

His colleague added 'our engineers for example wouldn't fraternise with competitors' engineers like the tax people'. The first colleague (**TE 3**) did add however, 'We don't advertise that so if the CFO knew that we talked to our colleagues, but that's too bad'.

TE 8 provided some explanation also:

> It is so much fun to...I think tax people just like to talk about their tax stuff...and I know the rest of finance doesn't do this...I don't know what it is but tax people have always loved that stuff.

Very importantly, some of the interviewees are very prominent active members of the institutes. **TE 9**, when speaking of his company's tax executives' involvement said, 'I think you would be hard put to find another company, except possibly for [a named company], that has been consistently more involved and played a prominent leadership role in TEI'.[214]

[214] Makes them well positioned to drive agendas around education and lobbying and are therefore 'powerful'.

Apart from his company's involvement in the TEI and SVTDG, **TE 8** added:

> We are big on MAPI ...has three tax councils and we have two people, myself and someone else who is active in that...one of my people is vice chair of the National Association of Manufacturers Tax Committee. We somewhat play in the National Foreign Trade Council, all the trade associations, The American Electronics Association, the ITAA which is a computer manufacturers association, we are on their tax committees. In the state of California...Cal Tax is big...we are on their tax and we try to do the same thing in other countries too, that's only more recently and the Tax Executives Institutes now has a chapter in Europe and one in Asia and we are very active in those.

TE 8's company (through its tax executives) is well positioned to exercise some form of influence over tax policy development and the development of practices and processes within in-house tax departments generally in SV. It's a similar story with **TE 10**:

> We belong to, we believe in being very proactive, changing laws, getting things to go our way so we are very externally focused. We belong to an enormous number of organisations. We run a lot of organisations and we do a lot of work to make it that, you know, [our company's] agenda gets to the right places. We do an enormous amount of that in the US, we do some of that overseas also to a certain degree...I'm a member of the Silicon Valley Tax Directors Group. I'm on the board of our local Tax Executive Institute Chapter. I'm a member of the American Electronics Association Tax Committee which sits here, the SIA Tax Committee which sits here, all of those. And then a bunch of organisations in DC and other study groups...I'm on the Board of San Jose State's Hi-Tech.

He went on to describe his relationship with FASB to reflect the extent of how externally focused [his company] is:

> There's a guy named Donald Thomas from the FASB, the Financial Accounting Standards Board, who is writing...certain tax position papers, for the FASB on how they're going to change all of their accounting and everything. We're on his speed dial. We get all his copies before they go anywhere and he calls us for, you know, opinions all the time. He comes out and visits us too. So, that's the kind of stuff we encourage, we want to help. **(TE 10)**

TE 23's story about another SV tax executive's motive for involvement in representative organisations is equally insightful:[215]

> I had a friend, I wouldn't say he's a good friend, I'm just giving you an idea. I had a friend who was a Tax Director of a company here, a very large company, and you know he gets asked to join a number of organisations and it's a company that is you know quite aggressive in tax planning and ...somebody I remember asked him 'you know, how do you decide which organisations you know you will be, you will join or you'll be active in?' He says, "I don't join an organisation unless I can control it". He says '"Well, I'm not interested in just being a member of an organisation, I want an organisation that I can influence to represent the best interest of my company"' and that's probably not an isolated viewpoint. So, you know where you think there's this so called supportive tax community, there are a number of people who are that way but there are a number of organisations who are participating...solely for the purpose of advancing their own company.

Perhaps importantly, seven of the 38 members of the SVTDG were among my interviewees and four other companies from which I had interviewees, have company colleagues as members. **TE 10**'s perspective on his staff getting involved with professional institutes is 'I push my people to do that'. In some contrast however, **TE 24** chose over the years not to be active within the institutes. He believes you have got to look at where you want to spend your time and for him it was never on TEI work. Interestingly, but not at all surprisingly, he added, 'I think none of my people have any interest in that. They don't want to be active'. He did add, 'Maybe you should do more but I didn't do that and I accept responsibility but I was working for my company, they were paying my salary'. Time and budget constraints also account for the lack of involvement in these institutes by some executives. **TE 18** for example would love to be a member of the SVTDG but cannot because 'we're so lean here'.

[215] **TE 23** would not perceive himself as a major networker or 'player'.

Importantly, smaller companies are quite happy with the big companies pushing the agendas of the representative groups. **TE 14** from one of the smaller companies said:

> So, the one good thing about being a small firm in this Valley is that my best interests generally will be taken care of by...the larger firms...they will fight for what they need and generally what they need is good for me...and that's one of the reasons why I stay in software...because of the Valley Coalition for Software...I have never found that something that the TEI puts out that I know that [named two VPs Tax in large SV-based companies] are behind or involved with somewhere. It has never been, I've never said 'Oh what are they doing?' It's like "yeah, you go".

While many of the institutes/organisations listed in Appendix 6 carry out *research* on tax and tax-related matters to varying degrees, it appears to be the primary role of a for-profit organisation, namely, the Corporate Executive Board Company. To reap the rewards of this research it costs $20,000 to join and $30,000 per annum.[216] While this company conducts research on many business areas, it is its tax roundtable that interests the in-house tax executives. **TE 19** described this roundtable as a 'think tank'. **TE 8** likes this one because:

> They do a lot of research and I get reports from them all the time but I am also, that is the only group where I can get to sit down with the guy from General Electric on occasion and General Electric has got a great tax department and they don't go to TEI meetings and they don't go to MAPI meetings but they go to this meeting. I resisted it but now I am a member, it's expensive...they run other groups too. They run a CFOs group and a controllers group and a treasurers group...they ask probing questions. They will do exactly what you did and publish it as research.

A lot of this research revolves around finding out what other tax executives are doing, through conducting extensive interviews and surveys.

[216] 2005 rates.

Unsurprisingly, the external advisors interface with the institutes if at all possible. They attend and are often invited speakers at seminars and conferences run by the institutes. According to **TE 13:**

> Even the law firms want to be associated with the Hi-Tech Institute and the TEI. Almost any seminar you go to you've got Baker McKenzie. You've got DLA Piper, you've got Fenwick & West and PWC, E&Y, all of them will come either through the Hi-Tech Institute of Dr Karlinsky or through TEI.

The potential benefits that the TEI (and others) can bring to SV-based MNCs is without doubt enhanced by the clustering of the technology sector physically in the Valley, as supported by **TE 17**'s comment:

> It's very unique here because in most areas...the types of businesses in New York and Chicago are so varied that...when stuff comes in and issues are discussed you know it's brokerage, it's just so many different areas. Here, it's primarily one industry, it's technology. Therefore, a speaker...can come in focused on technology issues and all the companies are interested. If you were a bank out here TEI would be almost useless to you because they never talk about your issues. But if you're a technology company TEI is just...it is an amazingly really effective group.

The interviewees are members of the different institutes for different reasons. It may be educational in which case the TEI seems to be very effective. It may be industry driven, for example the semi-conductor industry association's tax sub-group would only be of interest to those companies operating within that subsector of technology. It could be size-related, in which case a smaller group of VPs from the limited number of large companies would be of interest and value such as the SVTDG or the for-profit Corporate Executive Board. They all score highly however with respect to facilitating networking. While the different groups may have different priorities, **TE 24** wisely pointed out that you do need to belong to a lot of them 'because you never know where your value is going to come'.

Professional institutes and organisations are clearly very important external influences (sources of normative and coercive isomorphism) on all of the interviewees. In many cases the interviewees and their staff are members of various such institutes. Some institutes appear to have a technical tax focus across a broad range of sub-industries within the IT sector and provide a significant educational, lobbying and networking platform, as is the case for the Tax Executives Institute. Others, such as the Silicon Valley Tax Directors Group appear to be a more select group whose concentration is very significantly on lobbying. Yet other organisations are tax groupings within particular sub-industries in the IT sector, for example, the American Electronics Association. While all of these organisations provide valuable networking opportunities, each one also provides something unique to its members. These various groups are clearly important constituents of the organisational field level referred to earlier.

The combination of networking, relationship building, continuing education, the dissemination of research findings, the sharing of information generally apparent between tax executives in SV, and lobbying activities all of which are facilitated through the workings of various representative institutes and organisations (members of the organizational field) constitute 'multiple isomorphic pressures' (Edelman and Suchman, 1997). These contribute to our understanding of the origins of homogeneity (DiMaggio and Powell, 1991b) of tax plans, 'prevailing industry practices' (Suchman and Edelman, 1996: p.939) and processes within these MNCs. The roles being played by the various institutes, combined with contemplation of the language of 'tax circle', 'tax community' and 'social clubs' as used by the interviewees, suggests the existence of potential 'networks of power' in SV with respect to tax, a central notion within the endogeneity of law perspective (Suchman and Edelman, 1996; Edelman et al., 1999 etc.). The apparent intensity of social interaction (through formal and informal fora) between these tax executives results in a 'social reality' (Berger and Luckmann, 1966) very peculiar to the tax world of SV-based MNCs, whereby rationality is constructed and evolves, in part, at the external environmental level (Edelman et al.,1999).

Many of the representative organisations are extremely involved in lobbying, representing an interplay between organisations and legislators that reflects a 'highly endogenous and reciprocal' relationship (Suchman and Edelman, 1996: p.938) resulting at times in a softening of regulation that counters corporate interest (Edelman et al., 1999), or new regulations that serve their interests. Through lobbying activities which employ both 'symbolic capital' and 'social capital' (Covaleski et al., 2005), the representative groups and their members could never be accused of being 'passive pawns' (Scott, 2001) when it comes to tax laws. Their strategic responses (Oliver, 1991) appear to be managed in a coherent and effective manner, thereby making them 'active players' (Scott, 2001) in the construction and configuration of tax laws (Edelman and Suchman, 1997). The findings demonstrate the exercise of power and influence at the institute level and at the level of certain individuals (typically a long standing Sr. VP Tax of the largest companies), the 'elites' of tax in SV, driving agendas within the institutes. Some individuals appear to purposefully and craftily use the 'clout' of the representative groups to serve their own interests, which it would appear, frequently serves the interests of many others in SV. The latter may again explain homogeneity with respect to tax plans and practices in SV-based MNCs which is not surprising perhaps as many of these companies face similar business contexts and tax challenges. This play of power is an important element within institutional analysis (Scott, 2001), and the level of respect and extent of a hearing that these representatives and individuals appear to receive from key decision makers up to Congress level calls into question the effectiveness (to some extent) of the state as a source of coercive isomorphism (Scott, 2001), which according to Fligstein (1991), can alter the (tax) environment through its laws profoundly. There was also evidence of an endogenous relationship extending to compliance and standards with one company at least being consulted by FASB for assistance on one of its position papers.

The findings certainly suggest the level of information sharing between executives in peer and competing MNCs is particular to tax, even within the SV area, out of which there appears to be 'leaders' and 'adoptors' of tax plans (Dillard et al., 2004) happily co-existing. This suggests tax is still a 'black box' item in business.[217] I would argue however, that the sharing of information, particularly with regard to tax plans and technical advice on dealing with ambiguity in tax laws, serves to provide a necessary 'legitimacy' to one's tax positions, essentially amounting to an RM measure (see Chapter Six on RM). Sharing of all types of information however, always gives one a

[217] Although tax is more visible recently in the post-corporate scandals environment as noted in Chapters One and Six.

sense of social legitimacy, which is core within NIS (Powell and DiMaggio, 1991; Scott, 2001 etc).

7.2.2 The Revenue Authorities

All in-house tax departments have to deal with/liaise with the IRS and different Revenue Authorities around the world at some stage. It emerged throughout the interviews that worldwide Revenue Authorities are important actors in the external environment, and they have potentially a significant impact on the practice and process of tax planning in these MNCs. The Revenue, for the most part is typically responsible for tax collection and enforcement but would also have some input into future tax policy direction arising directly out of their tax collection and enforcement roles.[218] The evidence suggests the IRS in particular is a very important economic and political level actor, warranting this separate discussion on the 'relationship' between it and the MNCs in this study, through the tax executives.

TE 9 described the relationship with the IRS, clearly demonstrating it as something that is to be valued and needs to be managed:

> We never get confused as to where our loyalties lie and what our responsibilities are...we don't let the tax authority govern what we do, they are not our boss but still they are important. It's a relationship, there are certain things you could do that would do so much harm to that relationship relative to the benefit you got from it, that you don't want to do it.

Similarly, **TE 13** stated:

> I want to develop a good relationship with the IRS so I will never do anything which would jeopardise because it's not my money, right? I want to do the right stuff for the company and for the government and I'm like a semi-

[218] Based on my experience in tax practice.

government agent I call myself.

Somewhat similarly, **TE 16** seems quite concerned with how they are perceived by the authorities, 'the governments, the Revenue, the authorities out there, you know how they're perceiving you and how you're being looked at'. **TE 5** referred to tax authorities and 'the positions that they take, how they enforce the laws, I mean that is a huge impact on what we do'.

Many of the interviewees referred to having a 'good' relationship with the IRS. For **TE 3** this amounts to being professional and being able to have good conversations around technical issues. He summed up nicely the process of IRS officials coming to trust him and his team over time which again emphasises the importance perhaps of developing relationships over time with people (even from the IRS):

> It's an interesting process. I have been through three or four cycles since I have been here and they usually come in, very suspicious, 'here is a big company, lots of income, there must be something bad going on'. When they get into it and they realise that we try to do a reasonable job, we will be a little bit aggressive in certain areas, fine, we are not going to hide it from them and we develop a working relationship where we can have those sorts of conversations on what I would hope, as quick as possible, on technical issues, because that is more fun...It's not contentious on our part...the whole relationship is good but there are individual issues that can get pretty heated. **(TE 3)**

This relationship facilitates what is at times necessary debate among tax professionals from both sides on 'grey areas' within tax. **TE 11** described the VP tax as being 'very tied into the IRS'.

TE 8 referred to this relationship being part of his tax strategy (see Chapter Four), and knows everyone in SV wouldn't agree with it. He thinks that generally IRS officials are 'extremely professional and honest and forthright and hard working...I think we work hard to maintain that relationship. We do things to foster that relationship and we think that helps us'. (TE 8) He described how close a relationship with IRS officials can be:

> Tax guys like to think of the ethical responsibility of pointing out a math error that the government has made in the tax payer's favour. Now I think our ethical standards say you are supposed to disclose. But even if they didn't require me to disclose I always would point out a math error because, and it's clearly not in my best interests, but I think long term I am going to gain lots by pointing out those math errors...I never actually have a personal relationship with any of these people and in part most of them are prohibited by their own ethics to have personal relationships. But I do...you try to get to know these people, you ask them about their spouses and their children and when someone gets married you congratulate them, you don't send them a gift. (TE 8)

He doesn't want the IRS officials to be compromised either which he says may lead to them being less effective or needing to show themselves as being tough on [his company]. TE 19 thinks a good relationship with the IRS 'goes a long way'.

There was some evidence of a perceived increase in the level of aggressiveness within tax authorities towards taxpayers, which TE 8 attributes to being in response to the greediness shown by Enron and so forth:

> I think some companies got too greedy and therefore the word got out that all companies are greedy and that was a mistake, we all got tarred with that brush. Why we have SOX is because of Enron. So the rest of us weren't doing that stuff, so it's too bad.

Likewise TE 11 said:

> They've been clamping down and clamping down. They're much, very high in the compliance mode right now. So, they went from tax payer rights in '98, now the pendulum has swung all the way the other way and the IRS after Enron and everything else is going after a lot of aggressive corporate tax shelters and so on.

He referred in this context to more reporting requirements being imposed by the IRS.[219] He also referred to the fact that 'a lot of foreign tax auditors are taking totally unreasonable positions'. **TE 12** thinks 'the IRS has definitely taken a lot more aggressive posture'. **TE 14** spoke of the continuing theme recently set by the Commissioner of the IRS whereby 'enforcement is a number one priority for him'. **TE 15**, clearly unhappy with the situation believes the IRS and Revenue Authorities globally are all getting much more aggressive, and it is partly driven by the need for revenues:

> They're all broke...the strategy works in many, many companies. Because you know the people don't have the budget, they don't have the resources; they don't have the highly qualified tax departments so they throw their hands in the air. Whereas, with larger companies we tend to have the resources where we can push back. But in addition, you know that's the edict that's coming out of the Commissioner, it's coming out every, (sic) from every tax jurisdiction which is 'play hardball, these guys are scumbags'. No, when Commissioner Everson gets up and says "we'll go public with the guys that don't come in under whatever scheme" they want you to come in under. What's that? You're not getting a fair hearing any longer.[220]

TE 22 also referred to the IRS having recently 'gone after public accounting firms, gone after law firms, they've gone after brokerage houses' which he posits partly explains why service providers have become 'a lot more conservative with the advice or proposals that they bring to corporate clients these days'.

TE 15 referred to the need for the IRS (and other organizations, such as the OECD) to be in constant dialogue with the companies to understand how their business models work. They would argue that tax laws generally do not change fast enough to

[219] Reference made to M3 and Circular 230.
[220] This interviewee was referring to recent public statements made by IRS Commissioner Mark W. Everson.

reflect what is going on in the software business, which is changing at a rapid pace. 'Those conversations need to be going on more and more and more and unfortunately some of the organisations that really should, the OECD etc, they're not moving fast enough.' (TE 15)[221]

Interestingly, TE 8 referred to the importance of being open and sharing information with the IRS. As a demonstration of this, he showed me the rather complex diagrammatic representation of his company's worldwide structure — a very big wall chart with many lines connecting the various entities — all rather meaningless if one has not been walked through the detail by someone who knows it. We were off tape at this stage of the interview, but he did make a point of the fact that he shows the IRS officials this diagram on the basis that if they see he is willing to share that kind of information with them, he must have nothing to hide. [222]

TE 10 referred to the importance of his company being one of 18 participators in a pilot Compliance Assurance Program (a real time audit) being run by IRS. The rationale for participating is insightful:

> Well, first off I'm really getting tired of having to analyse reserves and all of this stuff on the accounting side so the more current you are, the less hassle you have on the accounting side, and as I told you our goal is to get the return filed properly the first time. So, if that will get us there I'm thrilled...the other point is the IRS always want pilot programs to be a success; I can't see a downside to this.

The IRS have been 'helped' by this company in other ways:

[221] There are policy implications around the need for timely legislative changes.
[222] Arguably this constitutes an aspect of the 'game playing' referred to by Picciotto (2007).

> We have helped the IRS totally design and re-streamline their audit processes. And some of their programs were actually programs they basically stole from us working with our local IRS team and then turned into national programmes to the point where they even copied my files. I want a royalty from them, I haven't seen it yet but it's very flattering. **(TE 10)**

Similarly, **TE 8** utilises the facility of Advance Pricing Agreements[223] when offered by the Revenue Authorities, because, in addition to providing certainty, the tax authorities who offer these arrangements:

> Like people to use them and so I think I build credibility with them by using their tools. Other people disagree with that and this isn't my strategy, this is the way we manage the department of about a group of ten of us and we came up with this strategy. I didn't come up with this myself.

TE 13 described an incident in which he:

> Worked well with the IRS team...in this case it took us a lot of convincing, a good relationship with IRS team...our relationship with the IRS was excellent. I think in the Valley you won't have any other company where you've got these issues ...or whatever and trying to resolve it amicably with the IRS.

He also referred to taking opportunities to meet important IRS officials at conferences and so on:

> This is a chance to meet the Commissioner....he's kind of flying in from Washington making presentations. All you have to do is shake his hand and say 'How are you doing...really nice, you guys are really helpful' and send him an email. I actually got emails from IRS that had the guy who was heading up, (sic) he's left now, started his own practice. A lot of times what happens is the IRS workers will have their own practices or they leave but you still keep in touch. **(TE 13)**[224]

[223] Such agreements were identified as tax risk management mechanisms as discussed in section 6.4.
[224] Borkowski (2005) addresses the impact and challenges (for the IRS) arising from the loss of IRS officials to the private sector. Further consideration of this is beyond the scope of this study.

Only **TE 24** spoke negatively about the notion of having a good relationship with the IRS, arguing that business and the IRS are very different with very different objectives and it is nonsense to expect that they could be 'partners'. This is, he said where he vehemently disagrees with some TEI members.

The relationship between the TEI and the IRS was also emphasised. According to **TE 11**, the TEI 'has a very good reputation with the IRS...it can speak for industry...is very influential with the IRS'. **TE 22** posited 'it's a group of corporate tax professionals that weigh in with the IRS on the nuts and bolts of tax planning and tax compliance and so they respect us'. **TE 1** said the TEI has:

> A fair amount of leverage with the Internal Revenue Service. So, as individual companies if we go to the Internal Revenue Service and complain about this, that or the other thing, it's one thing, but if TEI goes, the Internal Revenue Service does listen and I think they have made some changes as a result of input from TEI.

Having a 'good relationship' with the IRS (and Revenue Authorities generally) through inter alia, open dialogue, was (with one exception) considered to be very important. This importance stems particularly from a concern for building credibility with and thereby achieving 'legitimacy' in the eyes of the state (Carruthers, 1995). Interviewees were not explicit about the benefits of such legitimacy beyond believing it 'goes a long way'. Participating in IRS pilot programs and other initiatives such as advance pricing agreements was clearly identified as a mechanism through which this legitimacy is achieved. Specific evidence exists in relation to the endogenisation (Edelman and Suchman, 1997) of the IRS audit process, a process which in itself also achieves legitimacy (perhaps on both sides). IRS officials frequently attend the same conferences as the tax executives themselves, providing opportunities for tax executives and IRS officials alike to draw on good communication and relationship skills (Wilson, 1995) in developing and maintaining this apparently important relationship. The relationship between the IRS and these tax executives is clearly a recursive one, representing the dynamics of institutionalisation between key economic, political and organisational level actors (Dillard et al., 2004).[225]

7.2.3 Other External Influences

A number of other external influences emerged throughout the interviews which are addressed briefly here. Some of these influences, (for example the media), have already been highlighted and discussed in other contexts within this thesis (see section 6.3 for example) and will be revisited in this section only to the extent of new findings on such influences.

TE 3 referred to being influenced by certain *individuals* outside of the organisation which included lawyers, but also more generically, 'I suppose people who I respect more than others on an individual basis...your colleagues and people who you just have a good relationship with professionally'. The influence of the *media* was a recurring theme throughout the interviews (see section 6.3 also). **Advisor 1** emphasised the role of the media (and the general public) on tax policy maintaining it influences 'what is acceptable and what is not acceptable' tax policy. He used certain not so kind words when referring to the influence some economic journalists have.

[225] Tax advisors at the organisational field level also interact with the IRS on their clients' behalves, but addressing that particular relationship was not an objective of this study.

They have this influence he believes 'because politicians fear public perception'. **TE 19** said they pay attention to the news so there is 'a pulse on the media' at her company. Two views to the contrary on the influence of the media were provided. **TE 8** stated:

> I know the New York Times tried really hard, big on tax shelters and Forbes did and I think most of the investors just yawned at that stuff...They got more excited about Enron than they did, which was not tax-driven as much as just out and out fraud, but we didn't. I don't think anybody really worries as much that 'oh my gosh, the Wall Street Journal is going to write an article that says[his company] is involved in a tax shelter'. Most people go "ho hum" on those things now. We try to avoid it but I don't think it's impacting what I do.

TE 21 did not see the potential media impact as 'a big player' in tax planning suggesting really that if they were not comfortable with it in the first place they would not run with it i.e. 'the law is the law'.

TE 23 referred to the influence of *tax legislators*:

> Well, I mean clearly the lawmakers are a significant part of it. I mean, they're what constantly complicates our lives and really have very little understanding of, you know, what a reasonable tax is and what is really reportable and manageable and auditable.

TE 2 also spoke briefly of the influence of the EU. 'Yes, things like shifting of the presidency of the EU, because that is relevant, I think we have definitely been paying attention to that recently'. **Advisor 1** views the EU as 'a hugely significant player now in terms of influencing what can and what cannot be done' and will become an increasingly significant influencer of tax policy. He views it as probably a lot more influential than the Revenue (in Ireland) as almost everything the Revenue does or seeks to do, has to be in accordance with EU law. This trend is clearly important for these MNCs having such a presence across the EU, including Ireland in many cases.

TE 22 referred to the fact that they monitor the *OECD* and works through organisations (like the TEI) to comment. **Advisor 3** identified a company's *auditing firm* as having the most direct impact on its tax planning: 'They are the ones they negotiate their reserve with'. **TE 9** sees the auditor as a 'huge' external influence 'because of the increased audit scrutiny and pressure and interaction'. His colleague described them as 'a pain' in this context appearing extremely aware of the potential impact they might have on his own position within the firm:

> They influence a lot of what we do and they talk to the audit committee and if they say I've got a material weakness...some companies have said 'the auditors have identified a material weakness and here is our remediation plan' and they have fired their tax director. That is a big influence. I don't want them to have a remediation plan around here that says they fired me. **(TE 8)**

TE 11 stated:

> You know whatever you do you're going to have to run it through your audit firm. And they're going to have to...sign off on it on how you account for it so that definitely has, is, a big influence.

Very brief reference was also made to the external influences of the *tax advisors*[226] (TE 20), *SEC* (TE 19),[227] 'the *marketplace*...the financial analysts' **(TE 21)**, the *Treasury department* and the *Congress* (one committee on the Senate side and one on the House side) (Advisor 3). Important external influences operating at the economic, political and organizational field levels of analysis have been identified in this section and are incorporated in the descriptive framework presented in Figure 3.1.

[226] Notably, all interviewees draw on the Big Four accounting firms for tax advice and on a core group of large legal firms, including Baker McKenzie, Fenwick and West. All companies in the study are audited by one of the Big Four accounting firms also.
[227] Identified by TE 1 as 'a key external influencer because the SEC has become a lot tighter in a lot of areas. We have to be more rigorous in what we do because there is always the risk of an SEC enquiry regarding your tax reserves or whatever.'

7.3 External Affairs and Direct Lobbying

Section 7.2.1 addressed the involvement of the MNCs in lobbying indirectly via the various professional institutes and organisations of which the tax executives are members. This section is concerned with the extent to which and the processes by which these MNCs engage directly in lobbying on tax policy matters.

A number of these companies have external affairs personnel, usually based in Washington DC, with whom company tax executives are in regular contact. These peoples' brief in relation to tax is to lobby for particular tax policies and object to others. Company Nine has a 'legislative analyst' among its external affairs people based in Washington, whose focus is exclusively on tax legislation. Company Four has government relations staff, who 'work very closely with tax'. **TE 8** described his company's position whereby one of the tax staff 'spends more than 50% of his time on legislative matters, both the state and the federal and he is in Washington a lot. And we have a close relationship with Government Affairs, another department here.' Having a physical presence in Washington appears to be important: '[our company] has a Washington office. I think that helps in Washington, so the relationships are there, introductions are made.' (**TE 8**)

One company has within the tax group a Director of External Affairs who works very closely with [the company's] Government Affairs people and he is a member of many different trade groups. When talking about this person's work **TE 11** said, 'he doesn't like to call it lobbying but he spends a lot of time in Washington and in different states connecting with congressional staffers etc'. **TE 19** referred to her company's external affairs person (though not tax exclusive) who does 'testify before Congress on different issues affecting our industry or company, not necessarily tax specific'. **TE 22** referred to his company's 'lobbyist that works on US issues in Washington DC and we have another lobbyist that works on Sacramento and California issues'. They also write directly to the IRS or senators on occasion.

On a continuous basis therefore, many of these companies are liaising directly with politicians at Washington DC in relation to federal tax policy matters. Relationships are formed and these external affairs personnel are having an influence on tax policy. At times, some companies pursue a change in tax legislation (or propose a new piece of tax legislation) which specifically suits them and perhaps them only. TE 3 for example, referred to a couple of occasions where they essentially went it alone in crafting and proposing legislation that would be beneficial to [his company] only. TE 8 referred to having an input into the Homeland Investment Act (part of the American Jobs Creation Act 2004). **TE 10**, when referring to the work of his external affairs tax staff member said, 'he does an enormous portion of state stuff. So California State, they come to him to write laws'.

Lobbying directly with politicians however is a big investment in time and money. It suits many of the companies therefore, to pursue their lobbying activity through membership of various professional institutes and representative bodies. **TE 22** summed this up:

> If we have the issues somebody else usually has the issue too...it hasn't been too often where there's been an issue where we've taken it on by ourselves...there was one issue separately years ago that we worked with

> another company up in Portland in Oregon and we were successful but it was a lot of work and it took actually a couple of years.

TE 18 however, (from one of the smaller companies which does not have an external affairs function) said, 'Well, I influence policy, you don't have to be that big to influence policy but you have to be willing to put your money where your mouth is.' My findings suggest that generally only the very large companies can go it alone, they can afford to and it is worth their while. The latter has clear implications for tax policy development and for understanding who is driving the tax agenda.

The politicking that goes on through the external affairs and lobbying activities suggests a very political aspect of tax law making, with vested interests on both sides. As **TE 14** said:

> The legislation is political. All of the politicians want something. US legislation is too political. The legislators don't legislate, they are politicians. It's funny to hear them say, to think that they are statesmen, there is not a person in Washington DC who is a statesman. Statesmen care about their country...If you were to read this tax code, there are so many carve outs, there are so many special interests that are being met that it really does stagnate the ability to proceed.

Four of the five largest companies in this study are very active in engaging in direct lobbying, with dedicated external affairs executives placed in Washington, with a tax brief. These are perceived as powerful and political:

> That's one of the banes in the US that you know...there's so much influence by a small circle of corporations or other individuals in getting tax laws enacted, those laws, they affect us all but they're in place to optimise the needs of a few organisations ...that's how the game's played and you've got to be somewhat accepting of that if you want to be in the arena...I'd say there's maybe four or five companies in this Valley that shape legislation because they're focused on it, they're bright companies and they've got the resources. (**TE 23**)

The interviewees from these companies had clear views on the attributes (in italics below) of an effective lobbyist/external affairs person.[228] **TE 3** emphasised *communication skills and the ability to build good relationships with the 'right' people*:

> Even though he is not a tax person, he is able to simplify complicated things and communicate with people. It's an excellent skill and he has developed good relationships with tax and other government affairs people. He doesn't style himself as a tax person but he is able to get to the nut.

Similarly, **TE 8** said his tax staff member involved in lobbying 'has a skill of explaining tax matters simply', and pointed to the fact that he is not a very good technical tax person. **TE 3**, who is with the smallest of these four companies insightfully added:

> I think you can be as effective as the big guys if you are willing to spend a little bit of time and work within political, understanding that their job is politics. So if you can work with those people in that environment, you give them something and you get something in return and if half of them are supporting one thing, half the other, [our company] is a big US manufacturer...that can play.

Empathy and recognising some element of trading in the process, therefore, is extremely important. **TE 8** emphasised the importance in the 'game' of not just going to Congress in times of need:

> There are times when we will assist the legislature and the IRS on regulatory matters but it might not be something we really care about. You can't just go to Congress when you really care, they want to see you there all the time.

He sees this as linking with his concern about maintaining credibility with the government authorities (as discussed earlier, see section 7.2.2).

[228] I interpret 'successful' in this context to mean having the desired impact on tax policy.

Another key factor is *access to the right people*:

> Well, I think a lot of the effectiveness in politics back in Washington is access. Can you get in to see somebody and once you are in there...can you develop a trust there because they don't want to get burned? If you burn them once, you are gone...if you connect with the right guy they are perfectly willing to play with you. (TE 4)

TE 10 appears to have no problem getting access to key government decision makers all over the world:

> I do a little tour of the Far East and I'll go see the, you know, ministers of finance in, you know, five different countries and check with the tax folks etc. When I go to Ireland I go to visit all of the people from Sean Dorgan to the finance people etc. etc.. Always, we're constantly relationship building.[229]

Somewhat unsurprisingly, his explanation as to why he gets access to these people is:

> Well, a lot of that had to do with you build a plant there, they like you...and even in just investigating (sic). For example, we have never built a plant in Singapore but we've talked to them many times. And when I go to Singapore I usually visit, I try. I do personally an enormous amount of public speaking all over the world and recently, for example, I was speaking at a Tax Council Policy Institute in DC on kind of global issues. I asked the Singapore Minister for Finance if Singapore would like to actually come do a presentation on this....I've helped people along, you know, countries along even. 230

TE 24 also spoke of dealing directly with government ministers in Asia. He had just come back from such a meeting in Beijing. He also mentioned the fact that he secured very special tax breaks in Singapore, and many other companies since then have secured this, which he takes a lot of credit for. In the context of discussing a site selection process, **TE 11** described how they put together a 'negotiation plan' which revolves around direct and indirect taxes, obtaining certainty, finding ways to meet compliance obligation in that country and many other issues. This plan seems to be

[229] Sean Dorgan was head of the Industrial Development Authority, at the time of these interviews. This Authority is responsible for attracting foreign investment into Ireland.
[230] This interviewee was silent on what exactly was being negotiated.

the negotiating document with which they go to the government of the particular country involved. Certainty is the important thing:

> So, you know, get as much agreed upfront as possible and...understand that you're never going to get everything you want but try and maximise your wish list, you know, and some of that's around planning...how do you keep the tax cost low in these jurisdictions? (TE 11)

Very importantly he added, 'when you're bringing a large factory with a lot of technology you do have a lot of clout with the government'. His colleague, when pointing out the fact that they have tax holidays in some foreign countries claimed, 'you know, we're very close to the government' in these countries.

It is important to recognise that not all of the interviewees were engaged in direct lobbying. Interestingly, TE 2 who is with one of the largest five companies in the study stated:

> I am not really active in lobbying. I don't. It's not me. It's never been me, it's not something that interests me. I could see its value...and I think that there are occasions where something is being proposed where I feel strongly and I'll say something but it's just not part of what I do.

TE 18 related a story which demonstrates well the 'power' of a SV-based company and the game of negotiation with its wider political implications. He was trying to negotiate favourable terms with Dutch officials and when he wasn't getting his way he said to them:

> Silicon Valley is a very small place. We talk to each other all the time through the Tax Executives' Institute...I talk to people from [listed four of the largest SV-based companies] all the time, they're just down the street right! You think that when I get back and I talk to these people...do you think when I sit there and I tell them what my experience here is do you think they're going to want to talk to you? I said, 'I'm embarrassed...I'm Dutch and I have a desire to want to be here and you guys aren't rolling out the welcoming mat to me'. (sic) And so what happened was I got back here, all of a sudden I got a phone

> call from the Dutch...the Dutch Development Board, their bosses are flying over and they want to meet with you, they want to take you out for lunch. That's what they did. They came over and said, "well, we're sorry" and they've got a presentation going at Tax Executives because they want to go ahead and turn it around because of what I said. **(TE 18)**

External affairs incorporating direct lobbying with legislators/Congress staff is essential business for some of these companies. The larger companies invest a separate dedicated human resource to this activity which suggests there are benefits to it. The larger companies in this study clearly have done so, and utilize their 'power,' to demand and secure access to the 'right' people. Once access is secured, the associated benefits are made possible, which makes them even more powerful. The evidence strongly suggests some of the benefit lies in having a real input into shaping tax legislation in one's company's interest, but this is not necessarily in every companies', or perhaps even more importantly, the taxpayers' or the wider society's interest. These companies are involved in proposing tax legislation, and reacting to proposed tax legislation (Edelman et al., 1999), both of which are core elements of the endogenisation of tax law making which is highly evident in this study. It incorporates the active resistance to certain tax laws by the regulatee (McBarnet and Whelan, 1992). The language used by the interviewees of 'negotiation plan', 'game', 'play' is I suggest, also the language of endogeneity and is considered 'rational' by all of the 'players' involved.

This study gives some flavour of the dynamics of interaction between key economic, political and organisational field level actors, which gives rise to the need for some debate around the wider tax policy implications. Specifically, the regulatees appear to have a significant level of influence over the tax regulations that they themselves must ultimately adhere to. Legislators do appear through meeting with, and listening to, the external affairs executives of the MNCs to respond to parochial interests of targeted firms (Edelman and Suchman, 1997). The question of whether the degree to which this takes place, the means through which it takes place, and who the main influencers are, is understood in the wider taxpaying community should be addressed. The question of who should be judge and jury over the whole process also is an interesting one. This would require further research from other perspectives primarily that of the legislators/Congress staffers. Only then could one get a sense of the extent to which Covaleski et al.'s (2007b) 'second order effect' is at play (whereby regulators anticipate regulatee responses) which arguably brings some balance and pragmatism into the process. All of the latter would, of course, demonstrate clearly the constraining and enabling interaction (Dillard et al., 2004) between the different levels of analysis as portrayed in the framework used in this study, resulting in a necessary level of stability in the tax terrain generally which is in everyone's interests. These large powerful corporations also have great potential for shaping new laws and 'rational' accepted compliance processes and procedures in countries with less established tax regimes or where law enforcement is weak, but looking to entice these MNCs to set up operations in their respective countries.

7.4 Summary

This chapter identified key actors in the external environment namely the economic, political and organisational field levels of analysis (see Figure 3.1) with which in-house tax executives interact. While tax executives in SV are members of various professional institutes/associations, among the more influential professional associations in SV are the Tax Executives Institute and the Silicon Valley Tax Directors Group. The various institutes provide a significant educational, lobbying and networking platform, thereby influencing tax planning in practice, thus explaining some degree of homogeneity of tax plans and prevailing industry practices. The findings suggest the level of information sharing that takes place between the tax executives via the various networking and education opportunities afforded through active membership of such professional associations, is unique to tax, even within the SV area. The Revenue Authorities were identified as an extremely influential actor in the economic and political level of analysis with most interviewees attaching a high level of importance to their 'relationship' with Revenue Authorities around the world. Having a 'good relationship' with the Revenue Authorities is clearly an important aspect of gaining credibility and helps achieve 'legitimacy' in the eyes of the state. There was evidence to support the recursive nature of this relationship and its sometimes endogenous nature with respect to the IRS audit process.

Other external influences identified included the media, the EU, the auditing firm and Congress. Finally, external affairs and direct lobbying activities were shown to be essential business for some of these MNCs. Some of these companies are actively involved in proposing tax legislation and responding to proposed tax legislation, both of which are core elements of the endogenisation of the law making process. Attention is drawn to the potential wider policy implications of the dynamics of interaction between key economic, political and organisational level actors as was found to take place in this study.

8 Conclusion

8.1 Introduction

As described in Chapter One, this study is concerned with understanding tax planning in practice, identifying and taking account of the multiple arenas within which it operates, thereby highlighting its social and institutional dimensions (Hopwood and Miller, 1994). Empirically, it focuses on US MNCs. This study addresses four specific research questions as follows:

Research Question One: How is the tax planning function organised and conducted in MNCs?

Research Question Two: How is the performance of the tax planning function measured in MNCs?

Research Question Three: How is tax risk managed in MNCs?

Research Question Four: What is the nature of the relationship between the tax planning functions within MNCs and the external environment?

These research questions were operationalised by addressing a number of objectives within each question (section 3.2). Section 8.2 summarises the key findings and implications of this study. Section 8.3 highlights the empirical and theoretical contributions provided by this research and section 8.4 makes some recommendations for further study arising from the findings, observations and limitations of this study.

8.2 Findings and Implications

The key findings and implications are presented here, drawing on the major themes which emerged in the course of addressing the four research questions and associated objectives as set out in section 3.2.

Power

The role of 'power' (for example, Perrow, 1985; Dillard et al., 2004) and powerful actors both within and outside of each MNC was a recurring and important theme in understanding tax planning in practice. The tax function itself and its leader must be, and be seen to be 'powerful' in order to be taken seriously within an MNC. Sources of such power include the title held by the head of tax (the more prestigious the better), reporting lines (directly to the CFO in US is most powerful), length of time working in the one company (can build up 'institutional knowledge' over time), and raw tax knowledge and expertise gained through qualifications and experience (the tax 'knowledge experts'). Resources at a tax department's disposal, often driven by such factors as the power of the head of tax and the overall financial position of the company, is a critical source of power in this context. Resources available to the tax planning function in the MNCs in this study varied, representing a source of heterogeneity (Powell, 1991) with respect to the practice and process of tax planning among multinationals. Securing adequate resources is an ongoing challenge in light of tax needing to, and being best positioned to, respond to the ever-changing external business and regulatory terrains (Wilson, 1995; Porter, 1999b). These frequently provide sources of external shocks ultimately resulting in deinstitutionalisation and reinstitutionalisation of tax planning practices and processes.

The CFO emerged as one of the most powerful organisational actors in terms of tax being an integral part of how these companies do business. He is very well positioned to engage in the necessary political processes associated with the institutionalisation (Covaleski et al., 2007) of tax planning in practice, and thereby is a key player in setting the tax culture of an organisation. A new CFO can give rise to deinstitutionalisation and reinstitutionalisation of tax plans, practices and processes. The attitude of the CFO to the tax planning function impacts significantly on the degree to which it is embedded within an MNC's business activities generally (section 4.6.4).

A significant level of power and influence is also at play at the professional institute level (see section 7.2.1) and at the level of certain individuals such as the 'elites' of tax in SV as reflected in their respective lobbying activities. They often secure what could be considered privileged access to important decision makers at Congress level in their efforts towards the endogenisation of tax law. Policymakers need to be aware of who the powerful players are when 'negotiating' tax laws in the endogenisation process.

Tax Strategy and Embeddedness

There are variable practices among MNCs around the formalisation of tax strategy, and there is limited evidence of strategy needing or seeking Board approval. Some tax executives were not convinced that having a formalised documented tax strategy adds value. The various tax strategies/mission statements found to be in place reflect a mix of quantitative (as per Scholes and Wolfson, 1992; Porter, 1999a) and qualitative goals, which collectively reflect the roles of policeman, service provider and business partner alike provided by tax executives (Wilson, 1995). There was some evidence of frictions (Scholes and Wolfson, 1992) within a tax strategy, for example, where a company aspires to minimising cash taxes while maximising EPS. Whatever the degree of formalisation of a company's tax strategy, the tax executives strongly supported the idea that tax should not drive business decisions (section 4.6.1). Strategic alignment of tax is supported in practice through reporting directly to the CFO, having as senior a title as possible in the organisation (two internal sources of power identified above), and having regular meetings and updates with business units. Policymakers would be ill advised however, to focus on examination of a company's formalised tax strategy to gain real insights and understanding of a company's tax planning activities and processes.

Tax and other Departments

Findings in relation to the relationship between tax and other departments and business units were mixed and insightful. Despite acknowledging the value of having a sound knowledge of the business (Wilson, 1995), tax executives have only limited business knowledge, frequently obtained on a 'self-service' basis. Only a small minority of companies have formalised business partnership relationships to facilitate tax executives understanding the true nature of the business. On the other hand, educating non-tax personnel on the role of tax and its value add capability, while recognised as important, tends to take place over time in a rather ad hoc reactive manner, achieving varying degrees of success. There are some natural tensions and exercises of power (Fligstein, 1991) between tax and accounting personnel. A smooth and effective working relationship between tax and accounting personnel demands empathy as well as good communication (PWC, 2001; Wilson, 1995). It is difficult to see how tax executives can operate as 'business partners' (Wilson, 1995) without being more formally integrated operationally into BUs and other departments. However, such integration may be more likely now, due to the increased attention in tax RM by Management. As noted in section 6.2, this increased attention is in response to the increased level of regulation (for example, SOX) in this post-Enron environment.

Non-tax Costs and Frictions

The findings of this study in relation to non-tax costs raise a number of significant issues or shortcomings concerning non-tax costs as dealt with in the Scholes and Wolfson paradigm (1992). A core aspect of that paradigm is the consideration of all parties, costs and taxes in the pursuit of effective tax planning. Their framework attempts to understand the impact of taxes on business activities generally. Specifically, they purport that their framework can be used to understand how taxes affect decision making, asset prices, equilibrium returns and the financial and operational structure of firms (see section 2.2.4). Research to date which draws on the Scholes and Wolfson paradigm is positivistic, primarily focuses on the impact of tax rules on a firm's or individual's behaviour, and has a working assumption that non-tax costs and frictions (for example, transaction costs), are identifiable and measurable.

As noted in Chapter One, aspects of this paradigm were drawn upon from the very beginning, but methodologically I pursued an interpretive approach to understanding tax planning in practice. This resulted in findings which inter alia, advance our understanding of the impact of taxes on business decisions generally. While these findings support, in principle, the inclusion of all parties, taxes and non-tax costs (Scholes and Wolfson, 1992; Yancey and Cravens, 1998; Fallan et al., 1995) in any theoretical framework being applied in a quantitative manner, they also raise a number of significant issues or shortcomings concerning non-tax costs as dealt with in the Scholes and Wolfson paradigm. Their framework fails to capture significant non-tax costs which vary over time and across organisations. Scholes and Wolfson tend to incorporate only measurable non-tax costs, for example, restructuring costs or the restricted borrowing level that might be imposed by lenders through loan covenants. Not all relevant non-tax costs or frictions are measurable, which in itself perhaps questions or challenges the use of the word 'costs' which may well conjure up the notion of something that *is* measurable. Importantly, this study has found that tax executives are concerned with reputational risk (section 6.3), which is inextricably linked with the core NIS concept of 'legitimacy'. Understanding the extent to which a tax executive is concerned with personal or corporate reputational risk (as is done in this study) clearly enhances our understanding of the effect of taxes on business activities, yet it is not measurable, [231] and cannot be captured in any quantitative model. It is only through talking to the tax executives themselves that such frictions can be known and understood. Reliance on publicly available data alone, as is the case with Scholes and Wolfson-based empirical studies cannot tell the whole story, as non-tax costs transcend such data.

Chapter Seven sets out in detail the findings in relation to how tax management is organised and managed in the context of its external environment. Many of the companies in this study incur significant costs which do not feature in the Scholes and Wolfson framework, such as networking, research and lobbying (both directly and indirectly via representative bodies), time and expertise in proposing and drafting responses to proposed tax law changes. Some of these costs are 'endogeneity costs' i.e. costs incurred through engaging in the endogenous process of tax law making (section 2.3.4). Only some of these costs, which essentially represent an investment in tax planning, are easily quantified such as professional institute membership fees. Notwithstanding this, they cannot be ignored in any analysis of a company's investment in tax planning. Measuring the specific return on investment in tax planning through employing these mechanisms is virtually impossible due to the unavailability of the data required to do so.[232]

[231] For example, some interviewees spoke of how the potentially negative local perspective on a particular tax structure (in say Japan) ultimately led them not to go ahead with a structure that is actually economically efficient.

[232] Companies are unlikely to provide data on lobbying and networking costs or on the extent to which such costs can be directly related to specific amounts of tax saved etc.

The findings of this study in relation to non-tax costs has implications for future engagement with the Scholes and Wolfson paradigm and for one's methodological approach to research on understanding tax planning in practice which incorporates how tax affects business decisions generally. These findings also point to the need for Revenue Authorities to adopt a range of approaches in their attempts to understand business better, and specifically the role of taxes in business.

Performance Measurement

In relation to performance measurement of tax, a number of interviewees emphasised qualitative rather than quantitative measures. Although PM was recognised as an important, albeit difficult function, there was no consensus on the degree of formality around the PM process. Importantly, while tax executives are quite exercised about the ETR, many of them do not see it as an appropriate measure of performance as it is not totally within their control, and its use as a measure of performance may encourage aggressive tax planning. Notwithstanding this, the ETR cannot be ignored and educating around a stable or fluctuating ETR outside of an 'acceptable range' to certain internal actors such as the CFO and the CEO, and external actors such as market analysts (a source of coercive isomorphism) is paramount in securing legitimacy and credibility. A company's ETR relative to its peer companies' ETR is more important than the actual ETR itself and explanations of why they are different are frequently required of tax executives and also by internal and external interest groups. This clearly frustrates tax executives as many of them perceive it as a rather meaningless measure and an invalid measure of performance. Additionally, this raises concerns about its manipulation (through creative accounting or flexible accounting standards (Bauman and Shaw, 2005)) in serving the need for such legitimacy perhaps at the expense of shareholder wealth. Fetishing of the ETR continues however by CFOs, market analysts and others, despite the reservations highlighted in this study by tax executives in practice about what drives the ETR and who controls it (see section 5.3). Notwithstanding this, it is critical that academic researchers using the ETR as, for example, a measure of effectiveness of tax planning (Mills et al., 1998; Rego, 2003) at best recognise and seek to compensate for its shortcomings, as identified by tax executives in practice, and proceed with great caution. However, the appropriateness of using ETR in academic research as a measure of effective tax planning must be questioned in light of these findings.

All except one of the companies in this study measure performance of business units on a pre-tax basis. A post-tax basis is 'institutionalized' (Powell and DiMaggio, 1991) in that one company, having been introduced by a very powerful internal actor over 20 years ago. Interestingly, this company is perceived as a 'leader' (Dillard et al., 2004) with respect to other tax-based activities in SV (see Chapter Seven). However, it has not been followed in this respect by other companies in the SV, thus questioning the notion of a 'sheep mentality' existing among tax executives in SV-based MNCs. Tax executives are keen to remain the exclusive tax knowledge experts in their respective organisations, thereby maintaining control of the tax function. Despite not being terribly close to the business, and not always understanding the business (as evidenced in section 4.6.5) they feel they are best positioned to address the tax implications of the business activities both in terms of expertise and character. Arguably, it is something of a contradiction to demand of the business units to consider tax (through early consultation with the tax executives) in their strategic business decision making, yet not reward them for doing so (through, for example, a post-tax PM system). Tax executives are themselves thereby contributing to the 'black box' mentality frequently observed in relation to tax.

Risk Management

Inherently uncertain tax laws and an increasingly regulated environment have led to a heightened awareness of the need to identify and manage risks around tax planning. The result is undoubtedly a trend towards a more conservative and process-driven approach to tax planning generally, and indeed most tax executives in this study described their company's tax profile as 'conservative' or 'risk averse'. Uncertainty in itself results in effective tax policy (McBarnet, 2001a; Spilker et al., 1999) if it translates into conservative or low-risk tax plans, which are subject to debate and represent a 'tension' at the economic and political level of analysis.[233] Increased levels of regulation, such as SOX have pushed tax into the Boardroom agenda, thereby attaching an increased importance to tax RM within organisations. Concerns with legitimacy (Scott, 2001) both within the organisation and as perceived by the 'public' with respect to the tax executives' RM is clearly very important and is evidence of the different audiences to whom claims for legitimacy must be articulated (Perrow, 1985).

While tax executives have to manage a range of operational, planning and compliance risks (see section 6.3), many of them are particularly concerned about reputational

[233] Arguably, uncertainty itself is therefore a 'friction' which may constrain tax planning.

risk,[234] which is a friction (Scholes and Wolfson, 1992), both at a personal and a corporate level. The role of the media in this context is particularly striking, operating somewhat as a subtle, yet powerful catalyst in changing the attitude (McBarnet, 2001a) of some tax executives to the law, leading to the trend towards conservative tax planning referred to above. Uncertainties around dealing with foreign tax authorities featured prominently in the context of RM, particularly around the idea of foreign authorities copying already unpopular US tax rules and practices. In order to deal adequately with proposed and new tax regulations in non-US countries, many US MNCs need to address their current US-centric tax organisational structure (see section 4.2), whereby physically locating tax executives outside of the US may well be necessary, as opposed to desirable, purely from an RM perspective.

A range of tax RM mechanisms are employed across MNCs ranging from seeking opinions from external advisors, to applying a 'smell test' or assessing the 'atmospherics' of the situation. Competitor and peer company influence are significant in terms of deciding on appropriate and legitimate RM mechanisms or processes. It is difficult to know however if such 'rational' processes are more about the way RM gets presented to the outside world as opposed to actually reflecting the real practice of RM (Carruthers, 1995), in which case they may best be described as loosely coupled systems which relate to the different environments in which the tax executives operate (Scott, 2001).[235] Many of the interviewees posited that RM per se

[234] As noted in section 6.3 there is a conceptual overlap between reputational risk and the striving for legitimacy as per the NIS literature.
[235] These environments include auditors, shareholders, general public etc.

has not changed, it is just documented better now and perhaps it is a little too soon to comment on whether such documentation is ceremonial (Meyer and Rowan, 1991). The increased level of investment in RM (in time and money) in response to increased levels of external regulation needs to be evaluated by the regulators. Is it achieving what it set out to achieve, and if so, at what cost? This SOX-type regulation appears to be very regressive and policy makers should not continue to impose regressive regulation without at least assessing its effectiveness.

The External Environment

The tax executives in SV are members of a wide range of professional institutes and organisations. These are very important external influences on tax planning practices and processes within MNCs. The combination of networking, relationship building, continuing education, the dissemination of research findings, the sharing of information generally apparent between tax executives in SV, and lobbying activities all of which are facilitated through the workings of various representative institutes and organisations constitute 'multiple isomorphic pressures' (Edelman and Suchman, 1997). These contribute to our understanding of the origins of homogeneity (DiMaggio and Powell, 1991b) of tax plans, 'prevailing industry practices' (Suchman and Edelman,1996: p.939) and processes within these MNCs. The roles being played by the various institutes, combined with contemplation of the language of 'tax circle', 'tax community' and 'social clubs' as used by the interviewees, suggests the existence of potential 'networks of power' in SV with respect to tax, a central notion within the endogeneity of law perspective (Suchman and Edelman, 1996; Edelman et al., 1999). The intensity of social interaction (formal and informal) between these tax executives results in the construction of a 'social reality' (Berger and Luckmann, 1966) that is peculiar to the tax world of SV-based MNCs, where rationality is constructed and evolves, in part, at the environmental level (Edelman et al, 1999).

The lobbying activities of these institutes represents an interplay between organisations and legislators that reflects a 'highly endogenous and reciprocal' relationship (Suchman and Edelman 1996, p.938) resulting at times in a softening of regulation that counters corporate interest (Edelman et al., 1999), or new regulations that serve their interests. Some tax executives purposefully and craftily use the 'clout' of the representative groups to serve their own interests, which frequently also serves the interests of many others in SV.

Some companies in SV invest heavily in external affairs and direct lobbying with legislators/Congress staff, which frequently amounts to the endogenisation of tax law (Edelman et al, 1999). It gives rise to real non-tax costs (Scholes and Wolfson, 1992) which need to be taken into account in attempting to understand tax planning activities. The costs of such lobbying and the related return, typically in the form of desired tax legislation is difficult, if not impossible to measure, but simply cannot be ignored. Legislators do meet with, and listen to, the external affairs executives of the MNCs and frequently respond to parochial interests of targeted firms (Edelman and Suchman, 1997). The degree to which this takes place, the means through which it takes place, and who the main influencers are, as understood in the wider taxpaying community, should be addressed. Large powerful corporations who invest in direct lobbying on tax legislation also have potential for shaping new laws and 'rational' accepted compliance processes and procedures in countries with less established tax regimes or where law enforcement is weak, but who are looking to entice these MNCs to set up operations in their respective countries.

The IRS (and Revenue Authorities generally) was identified as a key actor in the external environment. Tax executives typically regard having a 'good relationship' with the IRS as important, which stems largely from a concern for building credibility with and thereby achieving 'legitimacy' in the eyes of the state (Carruthers, 1995).

The tax 'organisational field' in SV is a relatively stable environment, propped up by a set of regulations imposed from the economic and political level. Although they sometimes are uncertain, there is a very powerful and stable organisational field in place, in which there are a number of recognised powerful and influential leaders of tax who, through very well developed and maintained relationships with actors at the economic and political level, manage to secure tax laws (and the implementation thereof) that suit most companies in SV most of the time.

8.3 Contribution

In addition to the above findings, this study makes a number of significant and unique contributions to knowledge empirically and theoretically.

At an empirical level, this study involved interviewing the 'elites' of tax planning in practice i.e. senior tax executives in US MNCs. Securing access to such individuals is exceptional and the insights gained as a result are equally exceptional. As described in Chapter Three, the carefully selected interpretive methodological approach adopted in this research provides a new and rich perspective on tax planning in practice, highlighting some shortcomings of the positivistic approach (section 3.3.1).

At a theoretical level, this study involved developing a conceptual framework (Chapter Three), which (i) provides a rich descriptive framework of the tax arena within which tax planning takes place, drawing particular attention to powerful actors in the organisational field level of analysis; and (ii) uniquely combines relevant theoretical constructs from tax planning (for example, Scholes and Wolfson, 1992; Douglas et al., 1996), NIS (for example, Powell and DiMaggio, 1991; Meyer and Rowan, 1991; Scott, 2001) and endogeneity of law literatures (for example, Suchman and Edelman, 1996; Edelman et al., 1999). The strong explanatory power of this framework was in evidence throughout this study as detailed in Chapters Four to Seven inclusive. A small number of examples are worth noting here. Resources given to tax such as having a VP tax in place, regardless of the exact nature of his activities or real power vested in him, can facilitate the company being seen to take tax seriously, and thereby act as a symbol of 'legitimacy' (Scott, 2001). The endogenous nature (Suchman and Edelman, 1996) of tax law making positions the state as 'a negotiable contracting party' (Roberts and Bobek, 2004) as opposed to an 'uninvited party to all contracts' (Scholes and Wolfson, 1992). Professional qualifications and general work experience in themselves were shown to be unlikely sources of heterogeneity (Powell, 1991) within the tax planning arena but represent powerful sources of normative isomorphism (DiMaggio and Powell, 1991b). Transfer pricing and SOX were highlighted as areas within which mimetic isomorphic behaviour (DiMaggio and Powell, 1991b), a response to uncertainty, at international level is in evidence or being considered, which has tax policy implications. Understanding has been enhanced as to why some companies chose to be 'leaders' (Dillard et al., 2004), as opposed to 'late adoptors' in terms of implementing innovative or what might be considered 'aggressive' tax based structures. Such 'leaders' and 'adoptors' happily co-exist in the wider tax arena. Possible decoupling (Meyer and Rowan, 1991) was in evidence with respect to tax strategy reflected in the fact that some interviewees referred to a tax strategy being in place but was rarely if ever referred to or updated.

Finally, this study draws attention to tax policy implications of its findings, thereby informing tax policy debate (Shevlin, 1999), through inter alia, providing information which enhances a state's understanding of taxpayers' motivations and behaviour.

8.4 Future Research

There are a number of fruitful research opportunities arising from the findings, observations and limitations of this study. This study focussed on the views of currently employed tax executives in SV-based US MNCs. It could be extended to include the views of retired tax executives. Such executives would have many years of experience and would be able to relate the story of change in this domain. Such interviewees may also feel freer to speak since they would be no longer working for any employer/company and therefore no longer a 'player' in the tax arena in SV.
It would also be valuable to gain the views of other actors in the economic, political and organisational field levels of analysis on the various aspects of tax planning

addressed in this study. For example, ask the market analysts about their understanding of factors impacting on the ETR, and the importance (or not) of the ETR to them in their job. One could talk to the regulators about their perceptions around tax risk management processes in MNCs, and discuss the impact of corporate lobbying on tax legislation with members of Congress.

To further investigate the exact way in which, and the extent to which, endogenisation of tax law takes place, it would be useful to perform an historical analysis on publicly available data and correspondence between the regulator, representative groups and regulatees concerning the bringing into law of specific pieces of tax legislation, such as the Homeland Investment Act.[236] Such an investigation could shed additional light on the negotiable nature of tax law, and specifically assess the extent to which Covaleski et al.'s (2007b) 'second order effect' is at play (whereby regulators anticipate regulatee responses).

The findings from this study could be drawn on by researchers pursuing the positivistic approach to tax planning research by incorporating, for example, important non-tax costs (Scholes and Wolfson, 1992) identified here such as lobbying and networking costs.

The primary research method employed in this study, namely face-to-face interviews, combined with the nature of the subject matter at hand, meant that the findings are

[236] Part of the American Jobs Creation Act 2004.

inconclusive with respect to decoupling (Meyer and Rowan, 1991) of tax practices and processes in US MNCs. Pursuit of an alternative methodology incorporating the review of, for example, documented risk management (specifically in response to SOX requirements) or performance measurement processes, combined with the findings of this research should result in critical insights on the extent to which decoupling of such processes takes place and why.

Finally, different theoretical perspectives could be pursued to explain the findings of this study, for example, examining the performance measurement findings through the lens of earnings management literature.

Appendix 1: Guide for Preliminary Interview with Tax Advisors

Firstly request permission to tape the interview and explain confidential nature of the interview and importance given to anonymity.

1. Introduction and explanation of key research question and planned methodology: *How do US MNCs (operating in Ireland) create, formulate and administer their tax plans on a worldwide basis? (Tax plan: the tax aspects/structure of any business activity or plan).*

Interviews with international tax directors/VPs for tax in the ICT sector.

Emphasise that my main interest is in tax planning but some limited reference to tax compliance will be necessary.

2. Provide an overview of how you think the tax function is organised in these companies (reporting lines, is there a tax director on the Board, describe the process of the tax function etc).

3. Typically, what in-house company personnel do you give tax advice to in these companies? Who are the decision makers?

4. What is your view of the importance of the tax function in these organisations (at all levels ranging from the tax personnel to non tax personnel to board level)?

5. Tax and the Organisation

Tax and strategy-role of tax in business decisions in companies, to what extent are tax personnel consulted, what types of business decisions merit a tax input. Should tax matter more/less? If not, why not? Do your clients have a tax strategy? Do you assist them putting one together? How is it married to the overall business strategy? How is the strategic role for the tax function defined, mapped out, implemented, managed and monitored on an ongoing basis in complex ever-changing environment?

Organisation of the tax function-compliance versus planning, outsourcing (determinants of, and are you in this business?), use of external advisors, performance measurement of tax personnel, post v pre tax performance measurement of non-tax personnel, use of IT, use of ES.

Value-Added Tripod-in-house tax professional as policeman, service provider or business partner? Any other way of looking at it? How can in-house tax professionals add value? Importance of business knowledge, tax expertise and relationship skills? Resources? Tax powerhouses?

6. The Tax Planning Process

Technical nature of tax planning-how are these companies approaching tax planning technically (all parties, all costs, all non-tax costs, type of analysis, global approach, flexibility, anticipating future tax law changes around the world, working within the letter of the law versus the spirit of the law? Income shifting? Income reclassification etc. Types of tax plans, opportunities looked for? Key aspects of good tax plan? Are there key areas for tax planning e.g. jurisdiction, contractual forms, transfer pricing etc? Board level involvement? Formalised approach? Role of tax advisors?). Trying to get a real understanding of how you manage the tax planning process-qualitative versus quantitative? How best to do this?

Do you see tax planning as creative? (Innovations literature)

What type of modelling is done by tax planners etc?

Judgement and Decision Making(DM) in tax planning — different levels of decision-making, describe the tax DM process, rational versus political versus garbage-can etc. Sources of information? DM paradigm of organisational design leading to setting up decision units taking into account centralization, specialization and flexibility. Who are the real decision-makers? How best to get to understand this?

Risk Management and Tax Planning — Types of risk? Why do they exist? Do your clients have a tax risk policy? Do you advise them to have one? Do you assist them putting it together? Its key aspects? How does it marry with overall company risk policy? Impact of SOX? Tax aggressiveness? Dealing with uncertain tax legislation (current and future)?

7. Is tax legislation (national and international) getting more complex? If yes, is this good/bad for tax planning?

8. What are the characteristics of a good tax planner? What's required for effective tax planning and tax management?

9. Top 5/6 tax planning areas/topics facing these companies?

10. How has this particular tax advisory environment changed over the last 10/15 years?

11. Discuss the link/interplay between accounting rules and tax planning?

12. What do these clients want most from you when giving tax-planning advice?

13. What are greatest challenges facing you as tax advisor to these companies? Greatest frustrations? Opportunities? Importance of tax planning? Are tax advisors kept in the loop?

14. Now that you know what I am trying to achieve, what are the most interesting/important areas we have discussed and who in your view should I talk to in these companies to answer my research question?

15. Are there any aspects of the tax function that I have not referred to that you think I should? Any way I could make this research more interesting for you? In what way do you see academic research in taxation being relevant to your work, if at all?

16. Are there any specific aspects of the tax planning function/operation which I can explore through interviews which could not be investigated/explored by reviewing the financial statements?

17. Possibility of obtaining contacts in US MNCs in information technology sector, preferably at international tax director level.

18. What type of information do you think international tax directors will give me?

19. What do you think of the idea of meeting a number of people in an organisation as opposed to one person in different organisations?

20. Explore aspects of institutional theory e.g. what institutions are involved? What are the institutional dynamics? Importance of social culture and environment? Tax practice as form of legitimacy (to maintain support from external groups), changes in organizational practices in tax, effects of social expectations on organisation and its tax practices, decoupling, 3 levels of institutions etc.

Finally many thanks for your participation!

Appendix 2: Guide for Preliminary Interview with In-House Tax Executive

Firstly request permission to tape the interview and explain confidential nature of the interview and importance given to anonymity.

1. Introduction and explanation of key research question and planned methodology: How do US MNCs (operating in Ireland) create, formulate and administer their tax plans on a worldwide basis? (Tax plan: the tax aspects/structure of any business activity or plan).

Interviews with international tax directors/VPs for tax in the ICT sector.

Emphasise that my main interest is in tax planning but some limited reference to tax compliance will be necessary

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2. Briefly explain your position and provide an overview of how the tax function is organised in your company (reporting lines, is there a tax director on the Board, describe the process of the tax function in your company etc).

3. Discuss the link/interplay between tax and the accounting function in your organisation.

4. Who do the in-house tax professionals see as their 'customers'?

5. What is the company's view of the tax function in your organisation (at all levels ranging from the tax personnel to non tax personnel to board level)?

6. Tax and the Organisation

Tax and strategy-role of tax in business decisions in your company, to what extent are tax personnel consulted, what types of business decisions merit a tax input. Should tax matter more/less? If not, why not? Does you company have a tax strategy? How is it married to the overall business strategy? How is the strategic role for the tax function defined, mapped out, implemented, managed and monitored on an ongoing basis in complex ever-changing environment?

Organisation of the tax function-compliance versus planning, outsourcing (determinants of), use of external advisors, performance measurement of tax personnel, post v pre tax performance measurement of non-tax personnel, use of IT, use of ES.

Value-Added Tripod-in-house tax professional as policeman, service provider or business partner? Any other way of looking at it? How can in-house tax professionals add value? Importance of business knowledge, tax expertise and relationship skills? Resources?

7. The Tax Planning Process

Technical nature of tax planning-describe your approach to technical tax planning (all parties, all costs, all non-tax costs, type of analysis, global approach, flexibility, anticipating future tax law changes around the world, working within the letter of the law versus the spirit of the law? Income shifting? Income reclassification etc. Types of tax plans, opportunities looked for? Key aspects of good tax plan? Are there key areas for tax planning e.g. jurisdiction, contractual forms, transfer pricing etc? Board level involvement? Formalised approach? Role of tax advisors? How are the boundaries of tax planning set?). Trying to get a real understanding of how you manage the tax planning process-qualitative versus quantitative? How best to do this? Do you see tax planning as creative? (Innovations literature)

Judgement and Decision Making in tax planning- different levels of decision-making, describe the tax DM process, rational versus political versus garbage-can etc. Sources of information? DM paradigm of organizational design leading to setting up decision units taking into account centralization, specialization and flexibility. How best to get to understand this?

Risk Management and Tax Planning- types of risk? Why do they exist? do you have a tax risk policy? Its key aspects? Are controls in place? How does it marry with overall company risk policy? Impact of SOX? Tax aggressiveness? Dealing with uncertain tax legislation (current and future)?

8. Is tax legislation (national and international) getting more complex? If yes, is this good/bad for tax planning?

9. When you seek the opinion from an external tax advisor what are you looking for most from him/her?

10. What are greatest challenges facing the tax function in MNCs? Greatest frustrations? Opportunities? Importance of tax planning? Greatest recent changes?

11. What are characteristics of a good tax planner? What's required for effective tax planning and tax management?

12. What training and development do in-house tax professionals receive?

13. Now that you know what I am trying to achieve, what are the most interesting/important areas we have discussed and who in your view should I talk to in your company and US MNCs in general to answer my research question?

14. Are there any specific aspects of the tax planning function/operation which I can explore through interviews which could not be investigated/explored by reviewing the financial statements?

15. Are there any aspects of the tax function that I have not referred to that you think I should? Any way I could make this research more interesting for you?

16. In what way do you see academic research in taxation being relevant to your company, if at all?

Finally many thanks for your participation!

Appendix 3: *My copy* of Interview Schedule (includes probes)

Introduction

Briefly introduce myself, outline the main purpose of the interview (refer to the document sent to interviewee in advance), request permission to tape the interview, explain the importance of anonymity and that confidentiality is assured.

1. Background and organisation of the tax planning function

(i) Who manages and provides the tax planning function in your company?

Potential probes

How do you define the tax planning element of the tax function (as opposed to the tax compliance element)? Clarify the planning/compliance boundary.

How many people involved? At what level are they within the organisation? What is their background typically? What skills have they? Where are they based?

What are the reporting lines?

Have you any former tax advisors or IRS officials working in your tax department? How has this changed the operation of the department?

Where are tax plans created and administered? Is there a tax person on the Board? Who is responsible for what?

Is your tax department a cost or profit centre? Is it a service centre or strategic support?

Is the tax planning function well resourced? Is it sufficiently resourced to be a 'business partner'? Has SOX led to increased resources for the tax function?

How much time (%) is spent on tax planning by in-house tax professionals?

(ii) Who are the customers of the in-house tax department and describe the interaction (in nature and process) between this department and its customers?

Potential probes

Internal and external customers? Can you order them in terms of importance?

Why is this the order? What processes are in place to ensure your customers (particularly the most important ones) are satisfied? Are there tax user group meetings and do you receive feedback from these meetings?

Do you get opportunities to communicate to your internal customers through roadshows or seminars?

Does practice differ from written down rules/procedures governing your interaction with internal customers?

Do you provide (written) guidelines on tax issues for business units? How do you spread the tax message within your organisation?

What do you do to build and maintain sound working relationships with the Board, the heads of other functions and with operating managers to keep them 'tax aware'?

2. Tax and Strategy

(i) What is your company's tax strategy or objective(s)?

Potential probes

Is it formally documented? What determines your company's tax strategy? Why?

How was it decided on and by whom? The Board or CFO or tax department?

Should 'tax' have a role in implementing overall business strategy?

Is the tax function well-embedded in the organisation?

How does it complement overall business strategy? How could this be improved upon? What processes are in place to ensure it complements overall strategy on an ongoing basis?

In what types of business transactions is the tax team involved and at what stage in the business decision-making process do they become involved? Can you give me an example?

Do the tax personnel understand the business? What efforts are made to ensure they understand it?

Has your company's tax strategy changed? Why and how did this come about? Who made it change? What were the implications for processes/roles?

Does your company have a tax code of practice? Why? What does it state? Can I see it? How is its implementation monitored?

(ii) How important is the tax planning function in your company?

Potential probes

What/who determines the level of importance? Has the level of importance changed? Why?

What is CEO's and CFO's view of tax and what are the implications of these views on tax planning in your company? What are their backgrounds professionally?

How embedded are these views?

How could the tax planning role be elevated within your company?

How is it viewed by other internal business units?

3. Performance Measurement

(i) How is the performance of the tax planning function measured in your organisation?

Potential probes

Is your effective tax rate (ETR) the most important measure? How do you calculate it?

What is a good ETR? Why? Do you work towards a target ETR and who sets that target? How is it determined? Does working towards a specific ETR ever lead you to be overly creative?

Who carries out the performance measurement?

How often? Are they in the best position to measure your performance?

What does your Board expect of you? Are the benchmarks clear?

Do competitors influence these measures/benchmarks? How important is it to 'keep out of trouble'? Any changes in performance measures? Why? How has the practice/process of tax planning responded?

What are the rewards/penalties for good/bad performance respectively?

Does practice match the official line on performance measurement?

How are performance targets set?

Are timescales set for tax planning projects and do they act as benchmarks?

What information is collected in order to measure performance and who collects it?

To what extent are things outside of your control taken into account e.g. changing tax rates? Are all of your customers involved in performance measurement? Are there conflicts between the various benchmarks used by different stakeholders/customers and how do you deal with such conflicts?

Are social and corporate governance obligations becoming (more) important measures of performance?

(ii) Are other business units measured on a post or pre tax basis?

Potential probes

Why? Do you see this changing? Why?

Would a post-tax basis be favoured in your company and by whom?

How does the current measurement basis impact on the relationship between tax and other business units?

How is this relationship managed on an ongoing basis?

Possible extra question

What is the purpose of performance evaluation of the tax planning function?

Potential probes

Is it for control/developmental reasons or simply to impose pressure?

4. Tax and Accounting

(i) Describe the interplay between the tax planning and accounting functions in your organisation.

Potential probes

Is tax personnel a separate and distinct group from accounting personnel?

Why is it organised this way? Should it be changed? Could it be?

Do tax and accounting personnel keep each other informed sufficiently?

What processes/practices are in place to ensure this interplay is effective?

What is the most important aspect of this interplay?

Do tax and accounting personnel perceive each other as internal business partners?

Examples of good/bad interplay between these functions?

(ii) Describe how the interaction between financial reporting and tax planning is managed in your organization?

Potential probes

Investors want high income reported whereas corporate taxpayer likes to see low taxable income? Examples of how accounting considerations (non-tax costs) resulted in not opting for a tax minimisation plan?

When a tax plan is being created or considered, how in practice are the accounting implications addressed and managed?

Has the interplay between tax and accounting changed? How and why?

In what ways have tax requirements shaped your accounting systems and practice? Or visa versa?

Are there structured activities and reviews of the impact of tax decisions on the financial reporting of material tax issues?

(iii) How is the tax reserve figure decided upon?

Potential probes

Describe the decision making process and who is involved? Is it contentious? Why? Examples?

What procedures govern your interaction with the auditors? Describe this interaction.

Possible extra question

Are there book-tax reconciliation disclosure requirements which impact on tax planning?

5. Risk Management

(i) What are the main types of tax risks facing your company?

Potential probes

Specifically describe the tax planning risks e.g. technical imperfections, over-aggressiveness, incorrect implementation.

How concerned are you about reputational risk (company or personal)?

How would you describe your company's tax risk profile – conservative/aggressive etc? How/who determines this and has it changed over time?

How do you deal with uncertainty in existing and future tax law?

How is judgment applied in uncertain situations?

(ii) What is your company's tax risk management policy?

Potential probes

Is it documented? Who drew it up and approved it?

In what way does your risk management practice help you deal with uncertainty in tax laws?

What processes are in place to ensure its implementation? Does it work well?

What internal controls/processes are in place in relation to taxation and how has SOX changed these? Are they enterprise wide?

What internal control framework are you using? The integrated framework published by the Committee of Sponsoring Organizations of the Treadway Commission (SEC endorsed)? This has 5 parts i.e. control environment, risk assessment, control activities, information and communication, and monitoring.

Are your internal controls documented? How? Policy manuals, process models, flowcharts, job descriptions, documents and forms?

What is the real value in practice of having an extensive tax risk management policy?

Does practice always reflect the policy?

Do other players in the 'organisational field' influence your approach/attitude to risk?

Are your tax advisors part of your risk management strategy?

Does the media have any impact?

Is the tax reserve setting process (referred to earlier) an important part of tax risk management?

How important is your external advisor to your risk management strategy?

Examples of good/bad risk management in practice in your company?

Is engaging in technically robust tax plans a part of your risk management policy or is the 'smell factor' more important?

How does the existence of super-principles or GAAR influence your approach to tax risks?

Does the Board set out acceptable parameters for the adoption of tax risk and monitor compliance with these parameters?

Is tax within the scope of the internal audit? What does it consist of? Is there any other external independent review of the tax function?

Are procedures in place to review current transactions for change of law implications, for consistency of technical argument and for concentration of risk? What are these procedures?

(iii) What are the greatest recent changes in tax risk management and how have such changes impacted on your tax planning practices and processes?

Potential probes

Have they made you more/less conservative? Have they resulted in more administration? Describe the impact of SOX on your company's tax planning activities?

Has it changed your approach/attitude to dealing with uncertainties in tax law?

Is it just more administration with/without real impact on tax planning?

Is SOX a constraint on tax planning?

Explain the administrative burden of SOX on your tax function? E.g. are ye minuting every meeting with tax advisors now?

Possible extra question

How does your tax risk management policy complement/originate from the company's overall risk management policy?

Potential probes

What processes are in place to ensure both policies are aligned? How is this alignment monitored?

6. Outsourcing and External Advisors

(i) Does your organisation outsource the tax planning function? Describe the process of outsourcing the tax function in your organisation and how it is managed.

Potential probes

Why? Is there a culture of outsourcing in your organisation?

Is the increasing administrative burden (due to SOX etc) leading to an increase/decrease in outsourcing?

Do internal tax executives bring more to the table than external consultants? How?

What types of issues do you tend to engage an external advisor for?

(ii) Who chooses your external tax advisors and what process and rules govern this task?

Potential probes

Are they tax lawyers or tax consultants from the Big Four?

How has SOX impacted on your choice of external advisor and quality of tax advice being received? Has it increased/decreased your costs?

How many advisors do you use?

What do you do to ensure your external advisors understand your business, strategy and structure?

Possible extra question

Describe how you use external tax advisors?

Potential probes

What are you looking for most from them in a tax opinion? Stamp of approval? Assurance that other companies have employed a similar tax plan?

What do you depend on them for?

Do you have rules or policies governing the engagement of external advisors?

Are consultancy fees agreed in advance?

Are they proactive?

Are you increasing or decreasing your use of external advisors for tax planning?

Do your external advisors rate their own letters of advice in terms of likely success of the tax plan they are advising on? Do you rely on this rating?

Do tax advisors tend to approach you with 'flavours of the month' tax plans or turnkey, one-size-fits-all projects?

Any significant changes in your relationship with external advisors? Are there pre-clearance procedures in place now which are necessary if you want to obtain tax advice from your auditors? What is the impact of this on tax planning?

Do your advisors rate their letters of opinion in terms of chances of success?

Do you rely on their professional indemnity cover?

7. Technical Approach to Tax Planning

(i) How do you arrive at the best tax solution for a particular business transaction or decision? Please use an example to describe the process e.g. employee compensation plan, choice of organisational form, choice of location, income shifting, income reclassification?

Potential probes

What practices and processes are in place which constitute (in part at least) your technical approach to tax planning?

At what stage did you engage external advisors? For what purpose?

Can you and do you obtain advance IRS rulings?

Did you consider all taxes, all parties and all non-tax costs and what did this involve in practice? How?

How would you classify the decision-making process e.g. rational/satisficing/political etc?

Are you constantly looking out for income shifting/conversion opportunities? What's the practice?|

How flexible are your tax plans and how do they cater for the consequences of the ever-changing tax laws around the world?

Did you use financial modelling? Any other techniques or analysis? Do you use expert systems and/or decision support systems?

How are the boundaries of tax planning set?

Where do you get your tax planning ideas from? Other companies?

Do you look for advance rulings? How is such a decision reached?

Do you like to be 'first out of the box' when it comes to creating/implementing new tax planning ideas? Are there 'leading edge' companies in this regard? Who would want to lead and why?

(ii) What types of tax plans need Board approval and what is involved in getting this approval?

Potential probes

Any changes in this practice?

Is there any other level of outside tax department approval necessary below Board level for lower scale tax plans? How does that work?

(iii) How are your global tax plans managed and monitored on an ongoing basis?

Potential probes

How do you keep abreast of the changing tax laws around the world, assess their impact on your existing structures and assess the possible tax planning opportunities arising there from? Is there a specific process in place? Examples?

Has this task changed over the years?

Does someone have responsibility for ongoing monitoring of bilateral tax treaties and assessing the impact of any changes on existing or planned business decisions?

Are primary (regulations and Court rulings) and secondary authorities (e.g. CCHs Standard Federal Tax Reporter or Tax Articles – any others?) on tax rules monitored and examined regularly in-house? To what extent do you rely on these secondary authorities?

Possible extra question

How do you react to new tax legislation to ensure its impact on existing tax arrangements is assessed and that new tax planning opportunities arising there from are identified assessed and possibly implemented?

Potential probes

What impact has The American Jobs Creation Act 2004 had on your tax plans/arrangements? What is the process for dealing with such legislation?

Do you have any preference for any particular approach to tax law e.g. exploiting gaps in the legislation, availing of express exemptions or adopting legal forms to fit inside the literal interpretation of the law?

Is your company receptive to 'flavours of the month'?

8. External Influences/Actors in the Corporate Tax Arena

(i) Who are the external influences on your company's overall approach to the practice and process of tax planning?

Potential probes

Individuals? Competitors? Professional organisations? Media?

Describe the type of influence. Who are the most dominant agents in the organisational field? Do you actively seek approval from these organisations? How do they penetrate the tax function in your organisation?

(ii) What organisations/institutions facilitate networking among tax professionals and how do you and your team engage with such organisations?

Potential probes

Tax Executives Institute? European-American Tax Institute? ABA (American Bar Association)? Are you a member?

Who are the most dominant agents in the organisational field? Do you actively seek approval from these organisations? How do they penetrate the tax function in your organisation?

Why are you a member of professional organisations? Do you network? How often and in what way? What is its value in real practical terms? Examples?

How do you engage with the organisational field and social/economic field? Examples of successful engagements? How do measure success in this context?

(iii) Who are the key regulatory bodies/participators influencing tax policy which applies to your organisation? Describe your interaction, if any with such bodies.

Potential probes

Government? EU? OECD? Public Company Accounting Oversight Board (PCAOB)? Congress? Do you interact with these organisations in order to influence tax policy? How and have you been successful?

9. Miscellaneous

(i) A company specific type question.

Company 1

Describe the role tax planning has played in recent restructuring activities in your organisation.

Company 2

Describe the role of tax and the tax planning process involved in your organisation's recent acquisitions.

Company 3

Describe the role that tax has played (if any) with regard to your organisation's (a) dividend policy and (b) business alliances.

Company 4

How does your organisation manage the tax uncertainties arising from dealings via the internet?

Company 5

Describe the role of tax and the tax planning process involved in your organisation's recent acquisitions.

Company 6

Describe the role of the Finance Committee with regard to tax planning.

Company 7

Describe the role of tax and the tax planning process involved in your organisation's recent acquisitions.

Company 8

Describe the role that tax has played (if any) with regard to your organisation's (a) dividend policy and (b) business alliances.

Company 9

Describe the role of tax and the tax planning process involved in your organisation's recent acquisitions.

Company 10

Describe the tax planning process involved when your organisation sets up and participates in strategic alliances.

Company 11

Describe the role of tax and the tax planning process involved in your organisation's recent acquisitions.

Company 12

Describe the role of tax and the tax planning process involved in your organisation's recent acquisitions.

Company 13

Describe the tax planning role and process (if any) concerning your organisation's business agreements with distributor companies.

Company 14

Describe the tax planning role and process with regard to your organisation's investment in research and development.

Company 15

Outline the ongoing role of tax planning where tax holidays and tax incentive programs are being availed of by a company over the next few years?

(ii) Give some examples of changes over time in the practice and process of tax planning. These changes could be formal or informal, revolutionary or evolutionary.

Potential probes

Why do less than optimal tax planning processes/practices persist over time? Complex interdependencies/exercise of power/taken for granted assumptions/path dependent development processes?

Possible extra question

What are the greatest challenges and opportunities facing the practice and process of tax planning within your organisation?

Note: There is a *'Possible extra question'* under some of the above headings. These questions were not included in the interviewee schedules but will be asked in interview, time permitting and if considered appropriate at the time.

Appendix 4: Research Brief for Interviewees

Tax planning is important for many organisations but a very limited amount of academic research has been conducted on how tax planning is done in practice. My main objective is to investigate tax planning processes in multinational corporations (MNCs) in the Information Technology (IT) sector. This research will provide a particular insight into the practice and process of tax planning in this sector. This investigation should provide a rich understanding of how MNCs create, formulate and administer their tax plans. It should also provide some insight into the social, political and economic context within which the tax planning activities of MNCs takes place. Ultimately this research should provide some interesting findings for corporate taxpayers and contribute to tax policy debate.

I will be conducting interviews with VPs for Taxes and/or International Tax Directors with fifteen US MNCs in the IT sector, and, given that I am based in Ireland, most of these MNCs have an Irish operation. The interviews with the various tax executives will be semi-structured and discussion on the practice and process of tax planning in an MNC will revolve broadly around the following themes:

- The organisation of the tax planning function within the MNC
- Tax strategy and its alignment with overall business strategy
- Performance measurement of the tax planning function
- Tax and Accounting, from both organisational and technical alignment perspectives
- Tax risk management

- Tax outsourcing and the role of external tax advisors
- Technical approach taken to tax planning within the MNC
- External influences/actors in the corporate tax arena

Discussion around these themes will explore the hows/whos/whats of judgement and decision making in a tax planning context and deal with changes in the tax planning function within MNCs.

Appendix 5: Final Codes developed in NVivo

Principal Codes	**Subcodes**
Background/Organisation	Resources
	Planning and compliance
	Customers
	Relationship with business units
	Staff profile
	Cost/profit/service centre
Tax and Strategy	Importance of tax/embeddedness
	Tax mission
	Impact of CFO/change of boss
	Tax understanding the business
Performance measurement	Effective tax rate
	Post v. pre-tax basis
Tax and Accounting	Personnel interplay
	Technical interplay
	Tax reserve
Technical approach	Managing and monitoring global tax
	Tax v. non-tax costs
	Board approval
Risk measurement	Risk profile
External influences/actors	Relationship with/attitude to Revenue
	Networking and relationships
	External affairs/lobbying
	Organisations/institutes
	Media
	Audit company
Theoretical Aspects	Leaders and innovators
	Isomorphic forces
	Power
Outsourcing/Advisors	
Educating/selling Tax internally	
Competitors' influence	
SOX	
Big changes	
Challenges and opportunities	
Homeland Investment Act	
Wilson's tripod	
Miscellaneous	

Appendix 6: Summary of Institutes/Organisations

Name	Details
TEI *Tax Executives Institute*	TEI is the pre-eminent professional organization of in-house Tax Professionals. Our members are business executives who are responsible for taxation matters on an administrative or policy-making level, or whose work is otherwise primarily concerned with the problems of business taxation. TEI is dedicated to improving the tax system in a principled, effective manner. Improving the tax laws and their administration by reducing complexity and compliance burdens and by fostering cooperation and the exchange of ideas with government tax officials are TEI's key purposes — the principles that govern its action and by which it is judged. TEI's 7,000 members play a critical role in identifying issues to be addressed and collectively supporting those principles. www.tei.org
SVTDG *Silicon Valley Tax Directors Group*	The Silicon Valley Tax Directors Group is composed of representatives from leading high-technology companies with corporate offices predominantly located in the area between San Francisco and San Jose, California (widely know as the "Silicon Valley"). The group was formed in 1981 and now has 38 members. The group hosts visits of Federal, State and County tax law makers to the Silicon Valley for the purpose of sharing information about the high technology industries and enabling open dialog regarding tax policy. The purpose of the Silicon Valley Tax Directors Group is to promote sound, long-term tax policies that support the global competitiveness of the U.S. high technology industry. Members of this group believe that tax policies should enhance opportunities for productivity growth by encouraging and rewarding enterprises that develop goods and services that meet international market standards. www.svtdg.org
AICPA *American Institute of Certified*	The American Institute of Certified Public Accountants is the national, professional organization for all Certified Public Accountants. Its mission is to provide members with the resources, information, and leadership that enable them to provide valuable services in the highest professional manner to benefit the public as well as employers and clients. In fulfilling its mission, the AICPA works with state CPA organizations and gives priority to those areas where

Public Accountants	public reliance on CPA skills is most significant www.aicpa.org
SIA *Semi-Conductor Industry Association*	The Semiconductor Industry Association (SIA) is the premier trade association representing the U.S. semiconductor industry. Founded in 1977 by five microelectronics innovators, SIA unites 95 companies responsible for more than 85 percent of semiconductor production in this country. Our coalition provides domestic semiconductor companies a forum to advance the global competitiveness of the $115 billion U.S. chip industry. Through a network of corporate CEOs and working committees, SIA shapes public policy on issues critical to the industry and provides a spectrum of services to aid members in growing their own businesses. http://www.sia-online.org/home.cfm
AeA American Electronics Association	AeA (formerly the American Electronics Association), founded in 1943, is a nationwide non-profit trade association that represents all segments of the technology industry and is dedicated solely to helping our members' top line and bottom line. We do this in partnership with our small, medium, and large member companies by lobbying governments at the state, federal, and international levels; providing access to capital and business opportunities; and offering select business services and networking programs http://www.aeanet.org/
EATI *European American Tax Institute*	Even the greatest innovators can't think of everything themselves. Monthly roundtables and briefings keep you up to speed on current international tax topics. Held throughout Europe and in the United States, they provide unrivalled opportunities for creative planning, benchmarking and sharing. EATI gives you access to a unique network of over 400 members representing leading corporations and consultancies on both sides of the Atlantic. As well as providing a source of ideas and knowledge, it's an exceptional aid to recruitment, referrals and personal career development. Our newsletter and membership

directory will keep you up to date.

For two decades, EATI has been a leader in training and refresher courses to keep staff motivated, careers on track and professional expertise up to scratch. We hold courses and seminars in the US and Europe, covering US and European international tax topics. Each is designed to meet objectives specifically suggested by members, and we keep course sizes small to enhance discussion and focus on issues of most interest to the participants. Our courses qualify for continuing education credits.
http://www.e-ati.com/

ABA

American Bar Association

The Mission of the American Bar Association is to be the national representative of the legal profession, serving the public and the profession by promoting justice, professional excellence and respect for the law.

http://www.abanet.org/

NAM

National Association of Manufacturers

The NAM's mission is to advocate on behalf of its members to enhance the competitiveness of manufacturers by shaping a legislative and regulatory environment conducive to U.S. economic growth and to increase understanding among policymakers, the media and the general public about the vital role of manufacturing in America's economic and national security for today and in the future.
The NAM is the leading advocate of a pro-growth, pro-manufacturing agenda. The NAM is a partner in reinforcing the legislative and regulatory activities of its member firms. The NAM is a primary source for information on manufacturers' contributions to innovation and productivity.
www.nam.org

MAPI

Manufacturers Alliance

The Manufacturers Alliance/MAPI serves as a forum for the frank exchange of knowledge about leadership, management practices, and the global marketplace. As an alliance, we bring together executives to share expertise and to learn from one another. As a nonprofit business league, we engage in economic and policy research and benchmarking studies. As an advocate for our members, we support public policies that help foster continuing economic progress and a stronger, more efficient business sector. MAPI research and meetings focus on management practices, economics, and law, with an emphasis on issues critical to overall economic growth, innovation, free trade, productivity, and excellence in corporate management.

Our members are leading global companies in manufacturing and related business services, including electronics, aerospace, automotive, information technology and software, medical technology, precision instruments, pharmaceuticals, chemicals, and energy and utilities.

http://www.mapi.net/

USA CIB

US Council for International Business

Success in today's global marketplace is often a struggle of great ideas against stiff competition, regulation and red tape. It's no secret that some of the toughest of these road-blocks can be found overseas.

Leading American companies increasingly recognize that, to succeed abroad, they must join together with like-minded firms to influence laws, rules and policies that may undermine U.S. competitiveness, wherever they may be.

The United States Council for International Business helps companies do just that. It gives business a seat at the table, presenting American business ideas, values and solutions on a wide range of issues – from environment to e-commerce to labor relations – directly to U.S. policy makers and officials in the United Nations, European Union and a host of other governments and groups.

Originally founded in 1945 to promote free trade and help represent business in the newly-formed United Nations, USCIB has built an unparalleled global network of industry affiliations and a reputation for reliable policy advice. This enables our members to bring their collective views to bear on regulatory issues and business practices around the world.

By helping shape international regulation and expand market access for U.S. products and services, USCIB members can lower the costs of doing business abroad and enhance their long-term profitability.
www.uscib.org

TCPI

Tax Council Policy Institute

The Tax Council Policy Institute (TCPI) is a non-profit public policy research and educational organization. Its mission is to bring about a better understanding of significant tax policies that impact our national economy and businesses through careful study, thoughtful evaluation and open discussion. The TCPI accomplishes its mission in various ways such hosting an Annual Tax Policy Symposium in Washington, DC and sponsoring Mini-Symposia on important tax issues that are conveyed over the Internet.

http://www.tcpi.org/

US India Business Council

The U.S.-India Business Council is the premier business advocacy organization representing America's top companies investing in India, joined by global Indian companies, promoting economic reforms with an aim to deepen trade and strengthen commercial ties.

Celebrating its 33rd Anniversary in 2008, USIBC was formed in 1975 at the request of the government of the United States and India to involve the private sectors of both countries to enhance investment flows between the United States and India. Our primary mission is to serve as a direct link between business and government leaders, resulting in increased trade and investment.
http://www.usibc.com/usibc/default

High Technology Tax Institute

Since 1984, the Tax Executives Institute (TEI) and San Jose State University have sponsored the High Technology Tax Institute in Silicon Valley. The Institute's focus on relevant tax issues for computer companies, as well as pharmaceutical, biotech, communications, and aerospace industries makes it an invaluable, educational tax experience for accountants, attorneys, and corporate representatives who service high technology companies.

Each Institute session is designed to foster the sharing of tax planning ideas and problem solving strategies at a level consistent with TEI's and San Jose State University's high standards for professional tax education. Lectures are presented by nationally recognized practitioners and Treasury representatives who have practical experience of implementation.
http://www.cob.sjsu.edu/acct&fin/tax-institute/index.html

ITAA

Information Technology Association of America

ITAA offers a wide assortment of public policy, business development and peer to peer networking programs.

http://www.itaa.org/

NFTC

National Foreign Trade Council

The National Foreign Trade Council is the premier business organization advocating a rules-based world economy. Founded in 1914 by a group of American companies that supported an open world trading system, the NFTC and its affiliates now serve more than 300 member companies through offices in Washington and New York. The role of America in the world economy and the impact of international trade on the U.S. have never been more important. Leveraging its broad membership, expertise and influence, the NFTC is the only national business organization that exclusively advocates the international and public policy priorities of its members.

	From international trade, investment, tax, and export finance to human resource management, the NFTC's services and advocacy are a critical link for U.S. companies http://www.nftc.org/default.asp?Mode=DirectoryDisplay&id=1&Category=All
Cal-Tax	The most experienced tax policy and tax-lobbying staff in Sacramento resides with Cal-Tax. When working on tax policy problems before the Legislature, tax agencies, local governments, in court, or on statewide ballots, the Cal-Tax advocacy team is an effective business partner with member companies. This successful partnership between Cal-Tax and member companies has never been more important than at the present time. Cal-Tax staff members closely monitor legislative, tax agency, and local government tax policy deliberations and coordinate with Cal-Tax members and industry representatives to stop unnecessary tax policy changes that would increase its members' cost of doing business in California. Cal-Tax also supports changes that would have positive impact on industry members. Founded in 1926, our mission is to protect taxpayers from unnecessary taxes and to promote efficient, quality government services. We serve our members through research and advocacy on significant tax and spending issues in the legislative, e Founded in 1926, our mission is to protect taxpayers from unnecessary taxes and to promote efficient, quality government services. http://www.caltax.org/
ECITA *European Computer Industry Tax Association*	15 or 20 companies who meet say about 3 times a year in Brussels: 'It's a small group. It gets together and you just do a lot of sharing' **(TE 11)**. No website found.
Corporate Executive Board Company	The Corporate Executive Board provides best practices research, decision-support tools, and executive education to a membership of the world's leading corporations and not-for-profit institutions. Our research addresses issues related to corporate strategy, operations, and general management, and we focus on identifying management initiatives, processes, tools, and frameworks that will allow our members to avoid reinventing the wheel in addressing problems they share in common with their peers. At its best, our work is able to shape strategic debate and to accelerate tactical implementation in even the most progressive organizations.

Other organizations considered to be members of the external environment having some impact on the practice and process of tax planning are represented in Table...... All except the SEC are important actors at the OF level, while the SEC is at the economic and political level of analysis.

http://www.executiveboard.com/default.html -

WTO

World Trade Organisation

The World Trade Organization (WTO) is the only global international organization dealing with the rules of trade between nations. At its heart are the WTO agreements, negotiated and signed by the bulk of the world's trading nations and ratified in their parliaments. The goal is to help producers of goods and services, exporters, and importers conduct their business.
www.wto.org

FASB

Financial Accounting Standards Board

The mission of the FASB is to establish and improve standards of financial accounting and reporting for the guidance and education of the public, including issuers, auditors, and users of financial information.

www.fasb.org

PCAOB

Public Company Accounting Oversight Board

A private sector non-profit corporation, created by Sarbanes-Oxley Act 2002, to oversee the auditors of public companies in order to protect the interest of investors and further the public interest in the preparation of informative, fair and independent audit reports.

www.pcaobus.org

SEC *Securities and Exchange Commission*	The mission of the U.S. Securities and Exchange Commission is to protect investors, maintain fair, orderly, and efficient markets, and facilitate capital formation. www.sec.gov

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